

**UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT**

**BILATERAL INVESTMENT TREATIES  
1995–2006:**

**TRENDS IN INVESTMENT RULEMAKING**



**UNITED NATIONS  
New York and Geneva, 2007**

## NOTE

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UNCTAD/ITE/IIT/2006/5
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UNITED NATIONS PUBLICATION
<i>Sales</i> No. E.06.II.D.16
ISBN 92-1-112710-6
ISSN 1814-2001

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Printed in Switzerland

## PREFACE

The secretariat of the United Nations Conference on Trade and Development (UNCTAD) is implementing a programme on international investment arrangements. It monitors the trends in IIAs and analyzes the emerging issues and development implications. It seeks to help developing countries participate as effectively as possible in international investment rulemaking. The programme embraces policy research and development, including the preparation of a series of issues papers; human resources capacity-building and institution-building, including national seminars, regional symposia, and training courses; and support to intergovernmental consensus-building.

The programme is implemented by a team led by James Zhan. The members of the team include Victoria Aranda, Amare Bekele, Anna Joubin-Bret, Hamed El-Kady, Joachim Karl, Marie-Estelle Rey and Jörg Weber. The members of the Review Committee are Mark Koulen, Peter Muchlinski, Antonio Parra, Patrick Robinson, Karl P. Sauvart, Pierre Sauvé, M. Sornarajah and Kenneth Vandavelde. Khalil Hamdani provides overall guidance to the programme.

This paper is part of the programme's research and policy analysis on international investment policies for development. This research builds on, and expands, UNCTAD's *Series on Issues in International Investment Agreements*. Like that series, the paper is addressed to government officials, corporate executives, representatives of non-governmental organizations, officials of international agencies and researchers.

The main objective of this paper is to update UNCTAD's 1998 study entitled *Bilateral Investment Treaties in the Mid-1990s* and to identify trends in the normative developments of each of the elements typically addressed in BITs since this last stocktaking in 1998. The study traces and explains the new issues that have emerged in recent BITs and also sets out the implications of those developments for developing countries.

The study was prepared by Roberto Echandi and Anna Joubin-Bret. Joachim Karl, Amare Bekele, Bertram Boie, Hamed El-Kady and Jörg Weber finalized the paper. Comments at various stages were provided by Victoria Aranda, Rudolf Dolzer, Marie-France Houde, Mark Kantor, Karl P. Sauvart, M. Sornarajah, Ken Vandavelde and Christopher Wilkie. Desktop published by Teresita Ventura.

Supachai Panitchpakdi  
Secretary-General of UNCTAD

Geneva, February 2007



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## ABBREVIATIONS

APEC	Asia-Pacific Economic Cooperation
BIT	bilateral investment treaty
BoP	balance of payments
CARICOM	Caribbean Common Market
DR–CAFTA	Dominican Republic–Central American Free Trade Agreement
DSU	Dispute Settlement Understanding
DTT	bilateral treaty for the avoidance of double taxation (or double taxation treaty)
EIAs	economic integration agreements
FDI	foreign direct investment
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
ICC	International Chamber of Commerce
ICSID	International Centre for Settlement of Investment Disputes
IIA	international investment agreements
ILO	International Labour Organization
IMF	International Monetary Fund
ISDS	investor–State dispute settlement
MAI	Multilateral Agreement on Investment
MFN	most favoured nation
NAFTA	North American Free Trade Agreement
NT	national treatment
REIO	regional economic integration organization
TNC	transnational corporation
TRIMs	Agreement on Trade-Related Investment Measures
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization



## EXECUTIVE SUMMARY

Following up on a similar project in the mid-1990s (UNCTAD, 1998), the present study provides an overview of the main developments in the negotiation of bilateral investment treaties (BITs) between 1995 and 2006. In that period, not only did the number of BITs increase substantially, but also there were significant qualitative developments, as agreements tended to become more complex and cover a broader set of issues.

The main objective of this study is to identify trends in the normative developments of each of the elements typically addressed in BITs, as well as to trace and explain new issues that have started to be covered by recent agreements. The study contains three substantive sections. After an introduction, the main part analyses in detail the various approaches in BITs related to the substantive treaty provisions and traces and explains the new issues that have emerged in recent BITs. This is followed by a conclusion that provides an assessment of the main trends and sets out implications for developing countries.

Since the early 1990s, the number of BITs has increased significantly. A considerable degree of conformity has emerged in terms of the main contents of BITs, although with significant differences concerning their substantive details. On the other hand, the surge in BITs has been accompanied by a degree of normative evolution. This development presents new challenges for policymakers. While all BITs limit the regulatory flexibility within which contracting parties can pursue their economic development policies, more recent BITs include a wider variety of disciplines affecting more areas of host country activity in a more complex and detailed manner. At the same time, these treaties put more emphasis on public policy concerns, in particular through, inter alia, the inclusion of safeguards and exceptions relating to public health, environmental protection and national security. Furthermore, the interaction of BITs with other agreements at different levels, including the bilateral, regional, plurilateral and multilateral levels, becomes more complicated. As global economic integration deepens, managing the impacts of integration on the domestic economy becomes more demanding and the challenges involved in concluding BITs are correspondingly greater.

### *Developments with regard to main BIT provisions*

Against the background of more investment disputes, the negotiation of *preambles* has gained importance. Increasingly, these not only emphasize the objectives of investment promotion and protection, but also underline that this goal must not be pursued at the expense of other public interests, such as health, safety, environment and labour.

Most countries continue to conclude BITs with a broad asset-based definition of "*investment*". However, there is a trend towards excluding certain assets or transactions from the definition. Recently, Canada adopted a "closed-list" definition, enumerating in an exhaustive manner the assets that may constitute an investment. Concerning the definition of an "*investor*", various approaches continue to be used to determine the nationality of a legal entity. There has been a tendency in recent BITs to combine the criterion of incorporation with the requirement of also having the seat or the controlling interest in that country. "*Control*" by an investor of an investment is sometimes explicitly defined; one approach is to understand it as the power to appoint the majority of the board of directors or otherwise to legally direct the operations of the investment.

BITs that leave the contracting parties with discretion concerning the *admission and establishment* of foreign investors remain dominant. Nonetheless, treaties that include a "right of establishment" are becoming more frequent. This right is provided either through the granting of national treatment and most-favoured-nation (MFN) treatment or through the latter treatment only. It is subject to exceptions and reservations.

While most BITs include the standard of *fair and equitable treatment* — sometimes combined with the principle of *full protection and security* and/or the *international minimum standard* — only a small fraction of them clarify the meaning of this provision. Different approaches are in use — for instance, a statement that "fair and equitable" treatment does not mean more than what is prescribed by customary international law, a reference to international law, or the linkage of the fair and equitable treatment principle to non-discriminatory treatment.

Most recent BITs provide for *national treatment* in the post-establishment phase. Some agreements falling into this category make the national treatment standard subject to the domestic law of the host country.

All BITs under review contain the MFN principle. In most cases, there are exceptions to this rule with regard to privileges granted under treaties on the avoidance of double taxation and regional economic integration agreements. Despite some recent inconsistent arbitral awards on the scope of the MFN clause, BITs have not so far attempted to clarify its scope any further.

BITs of the last decade show a remarkable convergence concerning the legal preconditions for *expropriation or nationalization*. They require that the measure be non-discriminatory, for a public purpose, against payment of prompt, adequate and effective compensation, and with respect for the due process of law. BIT provisions differ on the degree of specificity with regard to the calculation and payment of compensation. Both direct and indirect expropriations are covered. The majority of BITs, however, do not explicitly deal with the newly emerging issue of regulatory takings.

A large number of BITs provide protection in the event of *war and civil disturbance*. Contracting parties are obliged to grant MFN and national treatment in such situations. Some treaties also specify the amount of compensation to be paid.

Most BITs include a clause on the *transfer of funds*, which gives foreign investors the right to transfer funds related to an investment without delay, and to use a particular currency at a specified exchange rate. There are differences regarding whether the provision covers both inbound and outbound transfers, whether any kind of transfer is protected or only those explicitly mentioned, and whether the transfer right is subject to national law. A significant number of BITs contain exceptions, mainly to ensure compliance with specific laws (e.g. on bankruptcy) or to safeguard flexibility for host countries to properly administer financial and monetary policies. The majority of BITs do not contain an exception clause dealing with a balance-of-payments crisis.

In the last 10 years an increasing number of BITs have included explicit provisions on the prohibition of certain *performance requirements*. The prohibitions tend to include service-related performance requirements and therefore go beyond the obligations in the TRIMs Agreement of the World Trade Organization (WTO).

Only relatively few BITs deal with the *entry and sojourn of foreign nationals*. They do not establish legally binding obligations, but only a "best efforts" commitment of contracting parties concerning the issuing of visas and work permits for nationals of the other contracting party engaged in activities associated with the investment. An increasing number of BITs explicitly deal with key personnel. The most common approach is to establish the right of foreign investors to employ key personnel of their choice, subject to domestic legislation.

Some BITs concluded since 1995 contain a *denial-of-benefits* clause. It allows contracting parties to deny treaty protection to those companies that are controlled by investors of a non-party and that have no substantial business activity in the territory of the party under whose laws they are constituted. In some cases, the clause is also meant to avoid granting treaty protection to investors of countries with which a contracting party does not maintain diplomatic relations or with regard to which an economic embargo exists.

A minority of BITs include *transparency* provisions. However, gradual yet significant qualitative progress has been made with regard to the rationale and content of such rules. While there has been a trend towards viewing transparency as an obligation imposed on countries to exchange information, new approaches also deem it to constitute a reciprocal obligation involving host countries and foreign investors. Transparency obligations are also no longer exclusively geared towards fostering exchange of information; rather, they relate to transparency in the process of domestic rulemaking aimed at enabling interested investors and other stakeholders to participate in that process.

Most BITs under review include *reservations* to one or more of the specific obligations in the agreement. In addition, there is a trend towards making it clear that investment promotion and protection must not be pursued at the expense of other key policy objectives. One technique used in this respect is to provide for general treaty *exceptions*. They may cover a broad range of issues, including taxation, essential security interests and public order, protection of human health and natural resources, protection of culture and prudential measures for financial services. Other BITs have included positive language to underline the responsibilities of contracting parties to safeguard society's core values. A small number of agreements contain a clause prohibiting or discouraging a lowering of environmental or core labour standards in order to attract foreign investment.

A group of BITs have undertaken to address *investor–State dispute settlement* procedures in greater detail, providing more guidance to the disputing parties concerning the conduct of arbitration and strengthening the rule orientation of adjudication mechanisms. However, the majority of BITs have continued with the traditional approach of only sketching out the main features of investor–State dispute settlement, relying on specific arbitration conventions to regulate the details. Some new BITs have incorporated various innovative provisions directed at fostering several objectives, such as to provide greater predictability, promote judicial economy, ensure consistency of awards and promote the legitimacy of arbitration procedures within civil society.

### **Conclusions**

Most BITs concluded in the last decade have a similar basic structure and content. However, this does not mean that agreements would be more or less identical or that there would not have been any normative developments. On the contrary, by looking into the details of each treaty one can distinguish a broad variety of approaches with regard to individual provisions. Differences exist with regard to the underlying rationale of the BITs, the degree of protection and the number of qualitative innovations.

Most recent BITs follow the traditional approach of establishing binding obligations only with regard to the post-establishment phase. However, the number of agreements also including pre-establishment rights is on the rise. Such BITs have predominantly been concluded by Canada, the United States and, more recently, Japan.

As a result, a growing number of developing countries actually apply two different BIT models, depending on who their treaty partners are: the "admission clause" model (mostly in BITs with European countries) and the "right of establishment" model (in treaties mainly with Canada and the United States). More than others, developing countries are therefore confronted with the challenge of keeping their BIT universe coherent.

Likewise, there is an emerging trend towards introducing treaty innovations, namely with the objectives of clarifying the scope of the definition of "investment" and the meaning of several key obligations, providing greater transparency in rulemaking, spelling out that investment protection should not be pursued at the expense of other essential public policy concerns, and improving the transparency and predictability of dispute settlement procedures. As in the case of pre-establishment treatment, these innovations have so far been basically limited to BITs concluded by a few countries, including Canada, Colombia, Japan, the Republic of Korea and the United States. It remains to be seen whether more countries will adopt this approach in the future.

Current BIT practice does not, in general, expressly deal with development matters beyond the inherent objective of BITs of investment protection. There is a need for further clarification of the interrelationship between existing standards of investor protection and investment promotion, on the one hand, and the best means by which development concerns can be (or should be) expressed in the future evolution of BITs, on the other hand.

## INTRODUCTION

In the absence of a global investment treaty, most international legal disciplines on the relationship between host countries and international investors have been developed at a bilateral level. Treaties establishing minimum guarantees regarding the treatment of foreign investment have existed for more than two centuries.<sup>1</sup> In the latter half of the 20<sup>th</sup> century, bilateral investment treaties (BITs) emerged as the first international agreements exclusively focusing on the treatment of foreign investment. In view of their similar legal structure, as well as the fact that BITs have burgeoned, these agreements rank among the most important pillars in international law on foreign investment.

Bilateral treaties on the promotion and protection of investments of investors of one contracting party in the territory of the other contracting party date back to 1959, when the first BIT was signed between the Federal Republic of Germany and Pakistan. Since that time, BITs had a relatively uniform content that had not changed markedly, apart from the introduction of provisions on national treatment and investor–State dispute resolution in the 1960s. Since the mid-1990s, however, the inclusion of investment protection provisions within larger trade agreements and the submission of a growing number of investment disputes to arbitration under investor–State dispute settlement provisions have led to some innovations in BIT practice, resulting in greater variation among these agreements than in the past.

The number of BITs continued to rise throughout the entire review period, reaching almost 2,500 at the end of 2005. However, since 2001 the number of BITs concluded annually has shown a constant downward trend; in 2005, 70 new agreements were concluded. This development contrasts with the surge in free trade agreements and other treaties on economic cooperation containing investment provisions. Whereas only 80 such treaties existed at the beginning of the review period, their number stood at 232 at the end of 2005 (UNCTAD 2006a, 2006b).

Mainly owing to the emergence of the latter kind of agreements, the scope of issues covered by investment-related treaties is expanding. They are no longer limited to investment issues per se, but also deal with related matters such as trade, services, competition, intellectual property and industrial policy (UNCTAD 2006c).

A growing number of BITs contain liberalization commitments. BITs are also becoming more sophisticated and complex in content (UNCTAD 2006d). Some countries have started to clarify individual treaty provisions and to make dispute settlement procedures more detailed. Treaties also emphasize in a stronger manner public policy concerns, such as those related to health, safety, security and environmental protection.

The evolution of the BIT universe is also due to the increase in BITs concluded between developing countries. In 2005 alone, 20 such treaties were concluded; this brought their total number to 644, whereas ten years before only 161 had existed. This development partially reflects the stronger role of some developing countries as capital exporters, which makes them actively seek the conclusion of BITs (UNCTAD 2005a).

Another element that contributed to the evolution of BITs is the surge in investor–State disputes over the last decade. While only six such cases were known in 1995, the number was almost 38 times higher at the end of 2005 (226 cases). This development is one of the main reasons why some countries seek to clarify individual BIT provisions with a view to reducing the risk of disputes in the future (UNCTAD 2005b, 2005c).

In 1998, UNCTAD published a comprehensive study entitled *Bilateral Investment Treaties in the Mid-1990s* (UNCTAD 1998). This document was one of the first studies ever published explaining the nature and content of BIT provisions. In addition, UNCTAD has published the *Series on Issues in International Investment Agreements*. That series addresses the basic conceptual framework and issues related to BITs. The present study neither purports to reiterate what has been explained in greater detail in those documents, nor does it intend to propose “best practices” in BIT negotiations. Rather, it attempts to present the diversity and the wide range of options, which can be observed from the BITs under review, and to identify major trends in the evolution of international investment rulemaking.

#### Note

- <sup>1</sup> The first Friendship, Commerce and Navigation Treaty signed between the United States and France in 1788 contained provisions regulating treatment of foreign investment.



## MAIN PROVISIONS OF BILATERAL INVESTMENT TREATIES: RECENT DEVELOPMENTS IN RULEMAKING

### A. Preamble

Most BITs are prefaced with a preamble, in which the contracting parties state their intentions and objectives when concluding the agreement.

Often, the preamble does not attract as much attention as the substantive BIT provisions since it does not establish legally binding rights and obligations. However, this does not mean that the wording of preambles is irrelevant.

The importance of the preamble stems from the fact that, as stated in Article 31 of the 1969 Vienna Convention on the Law of Treaties (hereinafter “the Vienna Convention”), it constitutes part of the context of the agreement. Consequently, the preamble is relevant for the interpretation of the treaty.<sup>1</sup> Contracting parties therefore need to ensure that the preamble is consistent with the substantive provisions of the BIT. Given the substantial increase in investor–State disputes, the specific language used in preambles might play a more significant role in the interpretation of BITs in the future.

From a political perspective, the preamble contains key messages of Governments to both national and international constituencies. They become more relevant as IIAs are critically looked at by some parts of civil society, both at a domestic and an international level. Thus, during the review period, an increasing number of countries have opted to include specific language in their BITs, aimed at making it clear that the objective of investment promotion and protection must not be pursued at the expense of other key public policy goals, such as the protection of health, safety, the environment and the promotion of internationally recognized labour rights. This trend has been reflected not only in the preambles, but also in the wording of substantive BIT provisions.

Two broad categories of preambles can be distinguished: the first group, which is by far the more numerous, includes those that focus on the importance of fostering economic cooperation among the contracting parties, promoting favourable conditions for reciprocal investments and recognizing the impact that such investment may have in generating prosperity in the host countries. An example is the preamble of the BIT between Mongolia and Singapore (1995). It states that:

*“DESIRING to create favourable conditions for greater economic co-operation between them and in particular for investments by nationals and companies of one State in the territory of the other State based on the principles of equality and mutual benefit;  
RECOGNIZING, that the encouragement and reciprocal protection of such investments will be conducive to stimulating business initiative and increasing prosperity in both States [...]”.*

Other BITs falling into this category include additional elements, such as the agreement between Brunei Darussalam and the Republic of Korea (2000), which also recognize *the importance of technology transfer and human resources development*. Furthermore, Australian BITs usually highlight issues such as *mutual respect for sovereignty*. These preambles also emphasize that investments are made within the framework of the *laws of the host country*. Some BITs highlight in the preamble the importance of *specific substantive obligations* included in the main body of the agreement. This is the case of the agreement between China and Djibouti (2003) (table 1).

Table 1. Examples of traditional preambles

BIT between China and Djibouti (2003)	BIT between Australia and Egypt (2001)	BIT between Brunei Darussalam and the Republic of Korea (2000)
<p>“The Government of the People’s Republic of China and the Government of the Republic of Djibouti,</p> <p>Intending to create favorable conditions for investment by investors of one Contracting Party in the territory of the other Contracting Party;</p> <p>Recognizing that the reciprocal encouragement, promotion and protection of such investment will be conducive to stimulating business initiative of the investors, flow of capital and technology, and will increase prosperity and economic development and that fair and equitable treatment of investments is desirable in both States;</p> <p>Desiring to intensify the cooperation of both States on the basis of equality and mutual benefits;</p> <p>Have agreed as follows:”</p>	<p>“The Government of Australia and the Government of the Arab Republic of Egypt ("the Parties")</p> <p>Recognising the importance of promoting the flow of capital for economic activity and development and aware of its role in expanding economic relations and technical co-operation between them, particularly with respect to investment by investors of one Party in the territory of the other Party;</p> <p>Considering that investment relations should be promoted and economic co-operation strengthened in accordance with the internationally accepted principles of mutual respect for sovereignty, equality, mutual benefit, non-discrimination and mutual confidence;</p> <p>Acknowledging that investments of investors of one Party in the territory of the other Party would be made within the framework of the laws of that other Party; and</p> <p>Recognising that pursuit of these objectives would be facilitated by a clear statement of principles relating to the protection of investments, combined with rules designed to render more effective the application of these principles within the territories of the Parties,</p> <p>Have agreed as follows:”</p>	<p>“The Government of the Republic of Korea and the Government of His Majesty The Sultan and Yang Di-Pertuan of Brunei Darussalam (hereinafter referred to as "the Contracting Parties"),</p> <p>Desiring to create favourable conditions for greater economic co-operation between the two countries and, in particular for investments by investors of one Contracting Party in the territory of the other Contracting Party on the basis of equality and mutual benefit,</p> <p>Recognising that the encouragement and reciprocal protection under international agreements of such investments will be conducive to the stimulation of business initiatives and will increase prosperity in both countries,</p> <p>Recognising the importance of the transfer of technology and human resources development arising from such investments,</p> <p>Have agreed as follows:”</p>

A second category of preambles additionally make it clear that investment promotion and protection need to respect other key public policy objectives. Such objectives may include the protection of health, safety, the environment and consumers, or the promotion of internationally recognized labour rights. It should be noted that this group of BITs also comprises agreements that follow the traditional approach of applying only to established investment and that do not contain specific provisions addressing issues such as labour or environmental standards (table 2).

Regardless of the specific content of the preambles, two trends can be identified. First, as the use of investor–State dispute settlement procedures increases, it is likely that countries will pay more attention to the specific wording of the preambles when negotiating a BIT. Second, an increasing number of preambles indicate that BITs do not purport to promote and protect investment at the expense of other key values such as health, safety, labour protection and the environment.

## B. Scope of application

The scope of application of a BIT has different dimensions. There is the subject matter to which the agreement applies — typically the investment made by investors of the other contracting party — the geographical coverage of the agreement and the temporal scope of application of the BIT.

Table 2. Examples of non-traditional preambles

BIT between the Republic of Korea and Trinidad & Tobago (2002)	BIT between the United States and Uruguay (2005)
<p>“The Government of the Republic of Korea and the Government of the Republic of Trinidad and Tobago (hereinafter referred to as "the Contracting Parties"),</p> <p>Desiring to intensify economic cooperation between both States,</p> <p>Intending to create favourable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party, based on the principles of equality and mutual benefit,</p> <p>Recognizing that the promotion and protection of investments on the basis of this Agreement will be conducive to the stimulation of individual business initiative and will increase prosperity in both States,</p> <p>Respecting the sovereignty and laws of the Contracting Party within whose jurisdiction the investments fall, and</p> <p>Convinced that these objectives can be achieved without relaxing health, safety and environmental measures of general application,</p> <p>Have agreed as follows:”</p>	<p>“The Republic of Uruguay and the United States of America (hereinafter the “Parties”);</p> <p>Desiring to promote greater economic cooperation between them with respect to investment by nationals and enterprises of one Party in the territory of the other Party;</p> <p>Recognizing that agreement upon the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the Parties;</p> <p>Agreeing that a stable framework for investment will maximize effective utilization of economic resources and improve living standards;</p> <p>Recognizing the importance of providing effective means of asserting claims and enforcing rights with respect to investment under national law as well as through international arbitration;</p> <p>Desiring to achieve these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of consumer protection and internationally recognized labor rights;</p> <p>Having resolved to conclude a Treaty concerning the encouragement and reciprocal protection of investment;</p> <p>Have agreed as follows:”</p>

Traditionally, most BITs have not included a specific clause to comprehensively address these different aspects in one single provision (UNCTAD, 1999a). Instead, the overwhelming majority have dealt with these issues in separate definitions of the terms “investment”, “investor” and “territory”, while clarifying the duration of the agreement in the “final clauses” of the BIT (UNCTAD, 1998). A number of BITs reviewed include, however, a specific clause to determine *ab initio* the scope of application of the BIT.

### 1. Scope of application clause

Specific clauses on the scope of application of the agreements are no substitute for the use of definitions as a means to delimit the subject matter of the BITs.<sup>2</sup> Rather, there are several reasons for using such a clause. In some agreements, it responds to considerations of legal drafting, aiming to clarify the *different dimensions* of the scope of application of the agreement in *one single* provision. Examples of BITs using this technique are those of Australia. The BIT between Australia and Uruguay (2001) states the following:

*“Article 2  
Application of Agreement*

1. *This Agreement shall apply to investments whenever made but shall not apply to disputes which have arisen prior to the entry into force of this Agreement.*

2. *Where a company of a Party is owned or controlled by a citizen or a company of any third country, the Parties may decide jointly in consultation not to extend the rights and benefits of this Agreement to such company.*
3. *A company duly organised under the law of a Party shall not be treated as an investor of the other Party, but any investments in that company by investors of that other Party shall be protected by this Agreement.*
4. *This Agreement shall not apply to a company organised under the law of a third country within the meaning of paragraph 1(d)(ii) of Article 1 where the provisions of an investment protection agreement with that country have already been invoked in respect of the same matter.*
5. *This Agreement shall not apply to a permanent resident of one Party where:*
  - (a) *the provisions of an investment protection agreement between the other Party and the country of which that person is a citizen have already been invoked in respect of the same matter; or*
  - (b) *the permanent resident is a citizen of the other Party.”*

A common trend among a number of recent BITs is to include an article emphasizing *one particular key aspect*, for instance the *temporal application* of the BIT. An example is the BIT between Austria and the Philippines (2002). It states that although the agreement is not retroactive, it applies to all existing investments of investors of one contracting party in the territory of the other once it enters into force:

*“Article 11  
Application of the Agreement*

*This Agreement shall apply to investments made in the territory of one of the Contracting Parties in accordance with its legislation by investors of the other Contracting Party **prior to as well as after the entry into force of this Agreement.**”* (emphasis added)

Other BITs emphasize that the host country retains full discretion and control over the admission of the investment into its territory, stressing the fact that the BIT does not grant any right of establishment to the foreign investor. Such discretion and control may entail formal requirements included in the host country’s domestic legislation, compliance with which may be crucial for determining whether the agreement applies to a particular investment. This clarification may be important for dispute settlement purposes.<sup>3</sup> An example is the BIT between India and Thailand (2000).

*“Article 2  
Scope of the Agreement*

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

As a result, the BIT would not cover an investment made in contravention of a formal requirement for written approval.<sup>4</sup>

Another category of agreements focuses on the *measures* relating to investments or investors rather than on the investment or investors of the other party, that is to laws and regulations existing at the date of entry into force of the agreement or adopted thereafter. An illustration is the new Canadian model BIT, which states:

*“Article 2  
Scope*

1. *This Agreement shall apply to measures adopted or maintained by a Party relating to:*
  - (a) *investors of the other Party; and*
  - (b) *covered investments. [...]*”

To limit the scope of application of the BIT in this manner may have significant practical effects for determining the universe of measures that could be challenged for purposes of dispute settlement procedures.

This issue was discussed in the initial disputes invoking the application of NAFTA's Chapter 11 on investor-State dispute settlement procedures.<sup>5</sup> In several cases, such as *Pope & Talbot* and *S.D. Myers*, Canada sought to have the arbitral tribunal decline jurisdiction on the basis that the measures challenged dealt with trade in goods, and as such, were governed by chapters of NAFTA other than the investment chapter. Consequently, the argument was that measures concerning trade in goods were not subject to arbitration under the investment provisions of Chapter 11.<sup>6</sup>

Arbitral tribunals established pursuant to NAFTA's Chapter 11 consistently held that measures concerning trade in goods can also be measures that "relate to" an investor or an investment. The tribunals have drawn on similar reasoning regarding the application of the WTO Agreements, in particular the GATT and GATS. In that context, the WTO Appellate Body has ruled that these agreements apply to measures that "affect" trade in goods or "affect" trade in services and, consequently, should not be read as applying only to measures concerning "goods" or "services".<sup>7</sup>

On the basis of the NAFTA experience, BITs applying to measures that "relate to" investors of the parties and their investments thus extend the scope of the agreement to any kind of measure affecting the investor or the investment concerned. Therefore, a broad range of regulations in the host country could potentially fall under the scope of application of the BIT. The subject matter to which the measures were primarily directed would be irrelevant.

## 2. Definition of terms

The purpose of definitions in legal instruments such as BITs is to determine the object to which the rules of the agreement shall apply and the scope of their applicability (UNCTAD, 1999a). The typical BIT protects investments made by investors of one contracting party in the territory of the other contracting party. The scope of the subject matter of the treaty thus depends on the definitions of certain key terms, particularly "*investment*" and "*investor*".

### a. Investment

Traditionally aimed at investment protection, most BITs define "*investment*" in a broad and open-ended manner, covering not only the capital that has crossed borders, but also practically all other kinds of assets of an investor in the territory of the host country. A significant number of BITs have included a standard definition of "*investment*", covering "*every kind of asset*" owned or controlled by an investor of another party. This is typically complemented by an illustrative list of assets included within the definition.

Given that different kinds of investment may have different economic implications and a different impact on development, the parties to a BIT may not wish to promote and protect all investment flows in the same manner. Thus, many BITs have narrowed the definition of "*investment*" in various ways. While some agreements have complemented the broad asset-based definition with a list of clarifications aimed at excluding certain kinds of investments, other countries have opted to use "closed-list" definitions — an approach that defines "*investment*" in terms of listing an ample but yet finite list of assets.

Among the BITs concluded since 1995, one can distinguish several kinds of definitions. There is the traditional "*asset-based*" definition, which, with several variations, has continued to be the most common approach. A second kind of definition, the use of which has diminished recently, is related to a "*circular*" or "*tautological*" approach, which focuses on the features of an investment rather than conceptualizing it. A third approach is a "*closed-list*" definition of investment. Fourth, there are techniques that exclude certain assets and transactions from the definition.

### (i) Asset-based definition of investment

Most BITs of the last 10 years have continued to adopt a broad “*asset-based*” definition of “investment”, the scope of which goes beyond covering only foreign direct investment. The definition covers “*every kind of asset*” or “*any kind of asset*”, accompanied by a list of examples. Such lists usually include five categories of assets: first, movable and immovable property and any related property rights such as mortgages, liens or pledges; second, various types of interests in companies, such as shares, stock, bonds, debentures or any other form of participation in a company, business enterprise or joint venture; third, claims to money and claims under a contract having a financial value and loans directly related to a specific investment; fourth, intellectual property rights; and fifth, business concessions, that is rights conferred by law or under contracts (UNCTAD, 1998, 1999a) (table 3).

**Table 3. Examples of “asset-based” definitions of investment**

BIT between Ghana and Guinea (2001)	BIT between Azerbaijan and Finland (2003)
<p style="text-align: center;">“Article 1</p> <p>Definitions</p> <p>“Investments” means every kind of asset and in particular, though not exclusively, includes:</p> <p>(i) movable and immovable property and any other property rights such as mortgages, liens or pledges;</p> <p>(ii) shares in and stocks and debentures of a company and any other form of participation in a company;</p> <p>(iii) claims to money or to any performance under contract having a financial value;</p> <p>(iv) intellectual property rights, goodwill, technical processes and know-how and all similar rights recognized by the national laws of both Contracting Parties ;</p> <p>(v) business concessions conferred by law or under contract, including concessions to search for, cultivate, extract, or exploit natural resources;</p> <p>A change in the form in which assets are invested does not affect their character as investments, provided such change is not contrary to the laws of the Contracting Party in whose territory the investment has been made. The term “investment” includes all investments, whether made before or after the date of entry into force of this Agreement.”</p>	<p style="text-align: center;">“Article 1</p> <p>Definitions</p> <p>The term “Investment” means every kind of asset established or acquired by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter Contracting Party including, in particular, though not exclusively:</p> <p>(a) movable and immovable property or any property rights such as mortgages, liens, pledges, leases, usufruct and similar rights;</p> <p>(b) shares, stocks, debentures or other form of participation in a company;</p> <p>(c) titles or claims to money or rights to performance having an economic value;</p> <p>(d) intellectual property rights, such as patents, copyrights, technical processes, trade marks, industrial designs, business names, know-how and goodwill; and</p> <p>(e) concessions conferred by law, by administrative act or under a contract by a competent authority, including concessions to search for, develop, extract or exploit natural resources.</p> <p>Any alteration of the form in which assets are invested or reinvested does not affect their character as investments.”</p>

A variation of an asset-based definition is the approach used in some agreements of the Russian Federation, such as the BIT with Japan (1998), which applies to “*capital investments*”. This concept is defined as follows:

*“Article 1*

- (1) *The term “capital investment” means all kinds of valuables, in particular:*
- a) the rights relating to movable and immovable property;*
  - b) shares and other forms of interest in companies;*
  - c) investment related right of claim of monetary means or any contractual obligation of financial value;*

- d) *the rights to intellectual property including patents, trademarks, industrial designs, integrated circuit designs, brand names, references to sources or origin marks and non-disclosable information; and*
- e) *concession rights including the right to prospect and use natural resources; Variations in the form of valuables investment do not affect their nature as capital investments.”*

At first glance, the use of the term “*capital investment*” in this definition suggests that the intent of the parties was to apply the BIT not to all kinds of investments, but only to those entailing a commitment of capital. However, it appears that the use of this particular term responds more to considerations of drafting than to such intent. “*Capital investment*” is defined as comprising “*all kinds of valuables*”, a notion that is clarified with the illustrative list comprising the five categories of assets usually included in asset-based definitions. Furthermore, to the extent that every asset has a value, the example cited above is only a variation of the typical asset-based definition.

The main objective of an asset-based definition is to guarantee protection of as many forms of investment as possible. However, a significant number of BITs have also included certain limitations on the scope of investment covered. During the review period, this trend has continued. An example is the BIT between Chile and New Zealand (1999), which defines “investment” as follows:

*“investment” means any kind of asset or rights related to it provided that the investment has been made in accordance with the laws and regulations of the Contracting Party receiving it, including, though not exclusively [...].*” (emphasis added)

Conditioning the coverage of an asset on compliance with local laws has several purposes. It confirms that both foreign and domestic investors have to observe the laws of the land, thereby establishing a “level playing field”. Moreover, this limitation implies that investment is covered only if consistent with the host country’s development policy, and other policies, as expressed in its domestic legislation (UNCTAD, 1999b).

Some recent BITs include the qualification that the assets must be invested by an investor of one party *in the territory* of another party. An example of this approach is the BIT between Algeria and Indonesia (2000), which defines “investment” as follows:

*“The term “investment” shall mean any kind of asset invested by investors of one Contracting Party in the territory of the other Contracting Party, in conformity with the laws and regulations of the latter, including, but not exclusively [...].*” (emphasis added)

Similarly, other BITs also establish the link between the asset and the territory of the host country by stating that for the former to be a covered investment, it has to be owned or controlled in the territory of the host country. That is the case of the BIT between Belgium–Luxembourg and Saudi Arabia (2002), which defines “investment” in the following terms:

*“[...] the term “investment” means every kind of asset, owned or controlled by an investor of a Contracting Party in the territory of the other Contracting Party according to its legislation and in particular, but not exclusively includes: [...].*” (emphasis added)

If the investment is an intangible asset, for example a debt or a right under contract, it may not be easy to determine whether an investor of contracting party A has in fact invested an asset in the territory of contracting party B. The SGS arbitration cases provide an example of such a difficulty.<sup>8</sup>

In those cases, the Governments of Pakistan and the Philippines respectively entered into contracts with SGS whereby SGS agreed to provide “pre-shipment inspection” services with respect to goods to be exported from certain countries to Pakistan and the Philippines. SGS undertook to inspect such goods partially abroad through its offices and affiliates. Accordingly, the two Governments argued that the investment in question was not made in their territories as required by the BITs. In the end, the tribunal did

not have to deal with this objection, because it considered it sufficient that according to the contract SGS had to make certain expenditures in the territory of Pakistan and the Philippines. These expenditures then constituted the investment.

### (ii) Tautological element in the definition of investment

The definition of “investment” not only requires a concept ample enough to cover the wide range of forms that investment can take, but also must be flexible enough to apply to new types of investment that might emerge in the future.

Some countries have responded to this need by introducing a tautological — or circular — definition of “investment”.<sup>9</sup> Numerous BITs concluded by the United States illustrate this approach, such as the BIT with Bahrain (1999). It defines an “investment” as “every kind of investment”. The definition reads as follows:

“ *Investment*” of a national or company means every kind of investment owned or controlled directly or indirectly by the national or company, and includes, but it is not limited to, [...]”

During the last decade, this tautological approach has not been very widespread, and virtually limited to those BITs of the United States during the first part of the period. However, in the BIT with Uruguay (2005), as well as in the negotiation of investment chapters of several free trade agreements, the United States has adopted a still broad, but more precise asset-based definition of investment (see subsection (iii) below). Such evolution in rulemaking might stem from the United States’ experience in the context of NAFTA’s Chapter 11 on investor–State disputes, where the definition of “investment” has been crucial in determining the jurisdiction of arbitral panels. Using a tautological approach implies that the contracting parties leave a significant degree of discretion to arbitral tribunals to interpret this concept.

### (iii) Closed-list definition of investment

A third approach that has emerged to avoid an excessively broad definition of “investment” is what is called a “closed-list” definition. This method differs from the broader “asset-based” definition in that it does not contain a conceptual chapeau to define “investment”, but rather consists of an ample, but finite list of tangible and intangible assets to be covered by the treaty. Originally envisaged as an “enterprise-based” definition used in the context of the United States–Canada Free Trade Agreement, this approach evolved towards the definition used in Article 1139 of NAFTA. It was not until the last decade that this approach began to be also used in BITs. It has been incorporated into the 2004 Canadian BIT model, which defines “investment” in the following terms:

#### *Article 1* *Definitions*

*Investment means:*

- (I) an enterprise;
- (II) an equity security of an enterprise;
- (III) a debt security of an enterprise
  - (i) where the enterprise is an affiliate of the investor, or
  - (ii) where the original maturity of the debt security is at least three years, but does not include a debt security, regardless of original maturity, of a state enterprise;
- (IV) a loan to an enterprise
  - (i) where the enterprise is an affiliate of the investor, or
  - (ii) where the original maturity of the loan is at least three years, but does not include a loan, regardless of original maturity, to a state enterprise;
- (V) (i) notwithstanding subparagraph (III) and (IV) above, a loan to or debt security issued by a financial institution is an investment only where the loan or debt security is treated as regulatory capital by the Party in whose territory the financial institution is located, and



- (ii) *a loan granted by or debt security owned by a financial institution, other than a loan to or debt security of a financial institution referred to in (i), is not an investment;*

*for greater certainty:*

- (iii) *a loan to, or debt security issued by, a Party or a state enterprise thereof is not an investment; and*
- (iv) *a loan granted by or debt security owned by a cross-border financial service provider, other than a loan to or debt security issued by a financial institution, is an investment if such loan or debt security meets the criteria for investments set out elsewhere in this Article;*
- (VI) *an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;*
- (VII) *an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraphs (III) (IV) or (V);*
- (VIII) *real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and*
- (IX) *interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under*
  - (i) *contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or*
  - (ii) *contracts where remuneration depends substantially on the production, revenues or profits of an enterprise;*

*but investment does not mean,*

- (X) *claims to money that arise solely from*
  - (i) *commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of the other Party, or*
  - (ii) *the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraphs (IV) or (V); and (XI) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (I) through (IX)"*

In addition to being finite, the list contains a series of specific clarifications to avoid applying the BIT to certain kinds of assets. This is an emerging trend among recent BITs. While countries following this approach intend to maintain the broad concept of investment, they include clarifications and additional language to make the definition of "investment" more precise. This point is developed below.

#### **(iv) Limiting the scope of the definition of "investment"**

A limited number of recent BITs, regardless of whether they use an asset-based or a closed-list definition of "investment", exclude certain assets and transactions from the scope of the definition of "investment". The specific exclusions vary among the different treaties. However, it is possible to distinguish two broad categories of excluded assets. The first group comprises real estate or other property not acquired for the purpose of economic benefit or other business purposes. The second type relates to certain financial assets or transactions, which are perceived as not entailing real acquisitions of interests by a foreign investor in the host country.

##### *1. Assets used for non-business purposes*

Although not very numerous, some BITs under review exclude from the definition of "investment" all real estate or other property, tangible or intangible, not acquired in the expectation or used for the purpose of economic benefit or other business purposes (table 4). A typical example of an asset falling into this category is the vacation home.

**Table 4. Examples of language variations used to exclude assets for personal use from the definition of investment**

BIT between Belarus and the Czech Republic (1996)	BIT between Mauritius and Swaziland (2000)
<p style="text-align: center;">“Article 1 Definitions</p> <p>The term "investment" shall mean every kind of asset <b>invested in connection with economic activities</b> by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter ...” (emphasis added)</p>	<p style="text-align: center;">“Article 1 Definitions</p> <p>"Investment" means every kind of asset admissible under the relevant laws and regulations of the Contracting Party in whose territory <b>the respective business undertaking is made, ...</b>” (emphasis added)</p>

Another technique to exclude certain kinds of assets is to insert the qualification that for an asset to be a covered “*investment*” it must have the “*characteristics of an investment*”, such as “*the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk*”. This approach contains once again a tautological element; it gives, however, some general indications as to the meaning of the term “*investment*”. This concept, which was first considered in the stillborn negotiations of the Multilateral Agreement on Investment (MAI) (UNCTAD, 1999c), has more recently been applied in the BIT between the United States and Uruguay (2005). The definition reads as follows:

“Article 1  
Definitions

*"investment" means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. [...]*

This definition does not list all the characteristics that an asset must have in order to be considered an investment. However, it does include three minimum parameters.

2. *Financial transactions that do not entail a real acquisition of interests*

The second category of assets that a few BITs have begun to exclude from the definition of “investment” are those related to transactions that do not entail a real acquisition of interests by an investor in the territory of the host country.

A first group of excluded transactions are debt instruments with short-term maturity periods. Some agreements, such as the new United States model BIT, do not specify the term “*short-term maturity period*” and leave its determination to a case-by-case basis.<sup>10</sup> Other BITs state that the excluded debt instruments are those with a maturity of less than three years. The purpose of this policy is to prevent volatile or short-term portfolio investment from being considered a covered investment. The requirement of a three-year maturity does not apply when the loan is made to an enterprise that is an affiliate of the investor. This exception has usually been included in the definition of “investment” used in BITs of Mexico.<sup>11</sup> An example is the BIT between Greece and Mexico (2000):

“Article 1  
Definitions

1. *"Investment" means every kind of asset acquired or used for economic purposes and invested by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter Contracting Party and, in particular though not exclusively, includes: [...]*

- c) *claims to money, to other assets and to any performance having an economic value, except for:*
  - i) *claims to money that arise solely from commercial contracts for the sale of goods and services,*
  - ii) *the extension of credit in connection with a commercial transaction, such as trade financing;*
  - iii) ***credits with a maturity of less than three years, by an investor in the territory of a Contracting Party to a natural or legal person in the territory of the other Contracting Party. However, the exception concerning credits with a maturity of less than three years, shall not apply to credits granted by an investor of a Contracting Party to a legal person of the other Contracting Party that is an affiliate of that investor; [...]*** (emphasis added)

A second group of transactions excluded in some agreements, such as the BITs of Canada, Mexico and the United States, are claims to money that arise solely from commercial contracts for the sale of goods and services by nationals in the territory of a Party to a national in the territory of another Party. For example, the BIT between the United States and Uruguay (2005) states that “*for purposes of this Treaty, claims to payment that are immediately due and result from the sale of goods or services are not investments*”.

The third sub-category of transactions is *public debt* in the form of payment obligations — loans or securities — of the State or a State enterprise. A reason justifying this exclusion could be that Governments do not want to establish in a BIT international obligations in relation to public debt, which could interfere with debt rescheduling in the framework of the “Paris Club”.

In conclusion, two trends can be observed with regard to the definition of “*investment*” in BITs. The overwhelming majority of treaties have continued to use the traditional broad asset-based definitions of investment. However, a growing number of BITs define the term “*investment*” with greater precision and exclude certain assets from the definition.

## **b. Investor**

BITs apply to investments made by *investors* of one contracting party in the territory of the other contracting party. Most BITs have traditionally included a definition of “*investor*”, which covers both natural and legal persons. There is the question of what kind of link a particular investor — either a natural or a legal person — needs to have with the contracting parties to justify protection under the agreement. The answer usually depends on whether the investor is a natural person or a legal entity; that is why BITs address those two categories of investors separately.

### **(i) Natural person**

With respect to natural persons, most BITs protect persons who have the nationality of one of the contracting parties. Thus, the typical definition of a national of a party is a natural person recognized by that party’s internal law as a national or citizen. This approach has not varied during the review period. Examples are the BITs between Angola and the United Kingdom (2000) and between Bangladesh and Japan (1998) (table 5).

In some cases, the definition of “*investor*” is even broader to include not only citizens but also individuals, who qualify as permanent residents under domestic law. For example, the BIT between Armenia and Canada (1997) states the following:

““*Investor*” means in the case of Canada any natural person possessing the citizenship of **or permanently residing** in Canada in accordance with its laws”. (emphasis added)

Table 5. Examples of definitions of nationals

BIT between Angola and the United Kingdom (2000)	BIT between Bangladesh and Japan (1998)
<p style="text-align: center;">“Article 1 Definitions</p> <p>[...] (c) “nationals” means: (i) in respect of the United Kingdom: physical persons deriving their status as United Kingdom nationals from the law in force in the United Kingdom; (ii) in respect of the Republic of Angola: physical persons deriving their status as nationals of the Republic of Angola from the law in force in Angola;”</p>	<p style="text-align: center;">“Article 1</p> <p>[...] (3) the term “nationals” means, in relation to one Contracting Party, physical persons possessing the nationality of that Contracting Party;”</p>

A few BITs concluded some decades ago required, in addition to nationality, the person to reside or be domiciled in the country of nationality.<sup>12</sup> However, among the BITs under review, that kind of requirement seldom exists.

There is also the issue of the coverage of natural persons having the nationality of both BIT parties under their respective laws. One possibility, following the international law principle of an effective link, is to consider a person with dual nationality as a national of the country of his/her dominant and effective nationality. This is, for instance, the approach in the BIT between the United States and Uruguay (2005), which defines “*investor of a Party*” in the following way:

*“Article 1  
Definitions*

***“investor of a Party” means a Party or state enterprise thereof, or a national or an enterprise of a Party, that attempts to make, is making, or has made an investment in the territory of the other Party; provided, however, that a natural person who is a dual citizen shall be deemed to be exclusively a citizen of the State of his or her dominant and effective citizenship.*** (emphasis added)

Another method is to consider a person who is a national under the laws of both BIT parties as a national of each country in their respective territories.<sup>13</sup> This approach has the effect of excluding such persons from the coverage of the agreement. An example is the BIT between Canada and Lebanon (1997). It states:

*“Article 1  
Definitions*

*“investor” means:  
any natural person possessing the citizenship of or permanently residing in one Contracting Party in accordance with its laws; ... who makes the investment in the territory of the other Contracting Party. In the case of persons who have both Canadian and Lebanese citizenship, they shall be considered Canadian citizens in Canada and Lebanese citizens in Lebanon.”*

Another method having the same legal effect is exemplified by the 2004 Canadian model BIT that defines “*investor*” as follows:

*“Article 1  
Definitions*

*investor of a Party means:*

*in the case of Canada:*

*(i) Canada or a state enterprise of Canada, or*

(ii) a national or an enterprise of Canada, that seeks to make, is making or has made an investment; in the case of \_\_\_\_\_;  
 \_\_\_\_\_;  
 that seeks to make, is making or has made an investment and **that does not possess the citizenship of Canada.**" (emphasis added)

This approach has the effect of denying treaty protection to Canadian individuals making an investment in Canada.

## (ii) Legal entities

Different criteria — in various combinations — have been used in BITs to define the nationality of a legal entity. These are the place of incorporation, the location of the company's seat — also referred to as the *siège social*, *real seat* or *principal place of business* — and the nationality of ownership or control.<sup>14</sup> As has been explained in greater detail elsewhere, each of these different criteria has its advantages and disadvantages.<sup>15</sup>

Numerous BITs concluded since 1995 use the place of incorporation or constitution as the sole criterion (table 6).

**Table 6. Examples of definitions of the term “investor” using the criterion of place of incorporation or constitution**

BIT between Sierra Leone and the United Kingdom (2000)	BIT between Belgium - Luxembourg and Pakistan (1998)
<p>“Article 1</p> <p>[...]</p> <p>(d) companies" means:</p> <p>(i) in respect of the United Kingdom: corporations, firms and associations <b>incorporated or constituted</b> under the law in force in any part of the United Kingdom or in any territory to which this Agreement is extended in accordance with the provisions of Article 12;</p> <p>(ii) in respect of the Republic of Sierra Leone: corporations, firms and associations <b>incorporated or constituted</b> under the law in force in any part of the Republic of Sierra Leone; (emphasis added)</p>	<p>“Article I.</p> <p>[...]</p> <p>1. The term “Investor” means: [...]</p> <p>b) any legal entity, including companies, association of companies, trading corporate entities and other organizations which is <b>incorporated</b> or, in any event is <b>properly organized</b> under the law of the Islamic Republic of Pakistan, the Kingdom of Belgium or the Grand-Duchy of Luxembourg.” (emphasis added)</p>

Unlike in the case of place of constitution or incorporation, it is not very common for BITs to use the criteria of the company's seat or the ownership or control as the *sole* condition for defining the nationality of a legal entity. An exception is, for example, the BIT between Peru and Venezuela (1996), which focuses exclusively on the control of a company by nationals of a party. The Agreement defines the term “enterprises” as follows:

### “Article 1

[...]

(3) “Company” applies to all judicial persons, including civil and commercial corporations and other associations which exercise an economic activity comprised within the ambit of this Agreement and that are effectively controlled, directly or indirectly, by nationals of one of the Contracting Parties.” (non-official translation from Spanish)

A significant number of BITs under review follow a different approach and combine several criteria. For instance, they require a company both to be incorporated in the territory of a contracting party and to have its seat or controlling interests in that country (table 7).

**Table 7. Examples of definitions of the term “investor” combining different criteria to ascribe nationality to legal entities**

BIT between France and Uganda (2002)	BIT between Argentina and Thailand (2000)	BIT between Chile and Turkey (1998)
<p>“Article 1</p> <p>[...]</p> <p>3. The term “company” means any legal person constituted on the territory of one Contracting Party in accordance with the legislation of that Party and having its <b>head office</b> on the territory of that Party, or controlled directly or indirectly by the nationals of one Contracting Party or by legal persons having their <b>head office</b> in the territory of one contracting Party and constituted in accordance with the legislation of that Party.” (emphasis added)</p>	<p>“Article 1</p> <p>1. The term “investor” shall mean: ...</p> <p>(b) any juridical person incorporated or constituted under the law in force in the territory of either Contracting Party whether or not with limited liability and whether or not for pecuniary profit and having <b>its seat</b> in the territory of that Contracting Party.” (emphasis added)</p>	<p>“Article 1</p> <p>1. The term “investor” means the following subjects who invest in the territory of the other Contracting Party in accordance with this Agreement: [...]</p> <p>(b) any legal person including companies, corporations, or business associations incorporated or constituted under the law in force of either of the Contracting Parties and having <b>their headquarters together with effective economic activities</b> in the territory of that Contracting Party.” (emphasis added)</p>

In general, different criteria are combined in cases in which Governments intend to limit the benefits of the agreement to those legal entities that have genuine ties with the home country. Vice versa, if the objective is to broaden the scope of application, agreements provide for alternative criteria.

Recent BITs do not show a significant evolution regarding the problems that could arise in the determination of the nationality of a legal entity. Thus, they do not address issues such as how to deal with companies having interests in both parties to a BIT, and what legal effects changes in the nationality of an investor during the duration of a BIT might have (UNCTAD, 1999a; Dolzer and Stevens, 1995).

**(iii) Clarifying the link between the investment and the investor: The issue of direct and indirect ownership and control**

The description of a particular asset as foreign — as opposed to domestic — investment depends on the link of ownership between that asset and the investor. Thus, at least in principle, the determination of whether a particular asset is a foreign investment should be very simple: if the asset is owned by a foreign natural or legal person it would be deemed to be foreign, and would therefore be a covered investment for the purposes of the agreement. However, the apparent simplicity of this formulation is misleading since a foreign investor may exercise rights of ownership in a direct or indirect manner. Foreign investment is often carried out through complex mechanisms entailing multiple layers of ownership. A huge number of shareholders may be co-owners of multinational enterprises, which have a vertical structure extending over several countries. How does international investment law deal with the legal issues derived from such complex business realities?

BITs often deal with this issue by perceiving “*control*” as the link between the investor and the investment. An example is the BIT between Austria and the United Arab Emirates (2001), which defines “*investment*” in the following manner:

*“Article 1  
Definitions*

[...]

(2) “*investment by an investor of a Contracting Party*” means every kind of asset in the territory of one Contracting Party, **owned or controlled, directly or indirectly**, by an investor of the other Contracting Party, [...]

The incorporation of the notion of control into BITs may be better understood in the light of the decision of the International Court of Justice (ICJ) in the *Barcelona Traction, Light and Power Co., Ltd. Case*.<sup>16</sup> In this dispute, the Court held that a company has the nationality of the country in which it is incorporated and that only the latter has the right of diplomatic intervention on behalf of the enterprise.<sup>17</sup> Thus, the ICJ held that the Belgian Government was not entitled to protect the Spanish interests of a company incorporated in Canada but owned principally by Belgians.<sup>18</sup>

The practical implication of this decision was that it did not permit diplomatic protection of shareholders whose nationality was different from that of the country of incorporation of the company. According to this ruling, much foreign investment would have had to be made without the possibility of diplomatic protection of the home countries of the foreign investors. This was avoided by incorporating the notion of “*control*” into the definitions of “*investment*” or “*investor*”. This approach renders the “Barcelona Traction” award inapplicable. Thus, assets indirectly owned or controlled by investors of the other contracting party are covered, regardless of the country in which the company directly owning the assets has been incorporated.

All BITs incorporating the notion of “*control*” into their definitions refer to “*direct*” and “*indirect*” control or ownership. This method highlights an important aspect of these treaties — namely, that they protect investments of nationals or companies of a contracting party, no matter how many corporate layers exist between the national or company and the investment. Consequently, more than one home country may exercise diplomatic protection (Vandevelde, 1992).

Incorporating the notion of direct and indirect ownership or control into the definition of “*investment*” or “*investor*” results in another challenge: to establish objective criteria to determine whether in a particular case an investor actually owns or controls an investment, either directly or indirectly.

Most agreements use the term “*own and control*” jointly and without distinction. Others draw a thin but distinct line between ownership, on the one hand, and control, on the other.<sup>19</sup> Definitions of ownership attempt to convey the idea that when an investor owns an investment — for instance, a company — it is because the investor owns a substantial part of the equity in it. Thus, definitions of ownership are often quantitative, requiring a particular percentage of ownership in the capital of an enterprise.<sup>20</sup> Definitions of control, instead, are qualitative.<sup>21</sup>

This distinction stems from the fact that control generally does not require majority or any specific quantum of ownership. Neither is it necessary that the investors *actually exercise* control.<sup>22</sup> Rather, it is sufficient that they have the power to legally conduct or direct the business of the company. In this respect, shareholders owning less than half of its stock may effectively control an enterprise. A single investor may control a company by holding as little as 5 per cent or even less of the total stock, provided that the remaining ownership is widely dispersed. In this regard, BITs often define the term “control” as the power to exercise decisive influence over the management and operation of the subsidiary. The BIT may further specify that this criterion is fulfilled if the investor owns at least 51 per cent of the shares or has the ability to exercise decisive control over the selection of the majority of members of the board of directors of the subsidiary.<sup>23</sup>

### 3. Geographical application

The geographical scope of application of a BIT depends on the definition of the term “territory”. The purpose of defining this term is not to delimit the territory of the Contracting Parties; that is an aspect normally dealt with in national constitutions. Rather, the rationale derives from the objective of investment protection, in particular to provide that investments located in maritime areas beyond the boundaries of the territorial waters are deemed to be within the parties’ territory for the purposes of the agreement (UNCTAD, 1999a).

The typical definition includes within the term “*territory*” those maritime areas over which the contracting parties exercise sovereign rights or jurisdiction in accordance with international law. This generally includes the continental shelf and the exclusive economic zone.

Notwithstanding minor differences in wording, most BITs of the last decade include a definition of “*territory*” and explicitly make reference to those areas over which the contracting parties exercise sovereign rights or jurisdiction under international law. An example is the BIT between Australia and India (1999), which contains the following definition:

“*Article 1*

[...]

f) “*territory*” means:

- (i) *in respect of India the territory of the Republic of India including its territorial waters and the airspace above it and other maritime zones including Exclusive Economic Zone and continental shelf over which the Republic of India has sovereignty, sovereign rights or jurisdiction in accordance with its laws in force and international law, including the 1982 United Nations Convention on the Law of the Sea;*
- (ii) *in respect of Australia the territory of Australia includes the territorial sea, maritime zone, Exclusive Economic Zone or continental shelf where Australia exercises its sovereignty, sovereign rights or jurisdiction in accordance with international law;*“ (emphasis added)

Other BITs state that the rights granted under international law are for purposes of exploration and use of natural resources. An illustration is the BIT between the Republic of Korea and Tajikistan (1995):

“*Article 1*

[...]

4. “*Territory*” means the territory of the Republic of Korea or the territory of the Republic of Tajikistan respectively, as well as those maritime areas, including the seabed and subsoil adjacent to the outer limit of the territorial sea of the above territories over which the State concerned exercises, in accordance with international law, sovereign rights **for the purpose of exploration and exploitation of the natural resources of such areas.**” (emphasis added)

Despite having important practical implications, not all recent BITs address the issue of sovereign rights in maritime areas. In some cases, BITs include a definition of “*territory*” but simply make reference to the area where countries exercise jurisdiction — without specifying the relevant criteria. A case in point is the BIT between Egypt and Thailand (2000):

“*Article 1*

[...]

The term “*territory*” means the territory over which a Contracting Party has sovereignty and/or jurisdiction.”

Not all BITs define the term “*territory*”. This is, for instance, the case of the BIT between Austria and Egypt (2001).

On the other hand, there is a group of recent BITs that define “*territory*” in a more comprehensive manner. This definition does not exclusively aim at clarifying the extent of the jurisdiction beyond territorial waters, but also makes reference to the air space and even artificial islands, installations and structures on the continental shelf. An example is the 2004 Canadian model BIT, which envisages the possibility for each party to include its own definitions of “*territory*”. However, with respect to Canada, and for the purposes of clarifying the geographical application of the agreement, it explicitly states the following:

“*Article 1*

[...]

“*territory*” means

- (i) *in respect of Canada:*



- (a) *the land territory of Canada, air space, internal waters and territorial sea of Canada;*
  - (b) *those areas, including the exclusive economic zone and the seabed and subsoil, over which Canada exercises, in accordance with international law, sovereign rights or jurisdiction for the purpose of exploration and exploitation of the natural resources; and*
  - (c) *artificial islands, installations and structures in the exclusive economic zone or on the continental shelf over which Canada has jurisdiction as a coastal state.*
- (ii) *in respect of \_\_\_\_\_”*

Similarly, Uruguay included the air space and continental shelf in the definition of “*territory*” in its 2005 BIT with the United States.

#### 4. Application in time

Regarding the issue of application in time, two main questions have traditionally arisen in BIT negotiations. The first is whether treaty protection should be extended to investments made before the entry into force of the agreement. The second issue relates to the determination of the period of application of the agreement, namely its duration and termination.

##### a. Application to existing investments

In accordance with the Vienna Convention, BITs — like any other international agreement — do not in general have retroactive effects.<sup>24</sup> The rights and obligations derived from a BIT apply only after the treaty has entered into force and with respect to acts or facts occurring thereafter.

There is the issue of whether BITs should apply after their entry into force to investments already existing at that time. Recent BITs have followed different approaches.

The prevailing trend is to provide protection to both future investments and investments already established at the date of entry into force of the agreement. Furthermore, it is stated that the agreement shall not apply to any investment-related dispute or claim that arose or was settled before the entry into force of the BIT.<sup>25</sup> A typical example of this approach is the BIT between the Republic of Korea and Nigeria (1998):

*“Article 12  
Application*

*This Agreement shall apply to all investments, **prior to as well as after** its entry into force, but shall not apply to any dispute concerning investments which was settled before its entry into force.”*  
(emphasis added)

Not all BITs, however, apply to existing investments.<sup>26</sup> A case in point is the BIT between Cyprus and Egypt (1998):

*“Article 12  
Application*

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

A variation of this method is to explicitly provide that the treaty shall apply only to investments made after a specific date. The BIT between Egypt and the Russian Federation (1997) illustrates this technique:

*“Article 13  
Application of the Agreement*

*The present Agreement shall be applied with respect to all capital investments, carried out by the investors of one of the Contracting Parties on the territory of the other Contracting Party, **beginning in January 1, 1987.**”* (emphasis added)

A third approach, although less common among the BITs concluded since 1995, is to not address the issue at all. This is the case of the BIT between the Philippines and Turkey (1999), and the agreement between Tonga and the United Kingdom (1997). In this situation, Article 28 of the Vienna Convention would apply.<sup>27</sup>

## b. Duration and termination

Unlike other international agreements, BITs usually specify that they shall remain in force for a minimum fixed period. The rationale for this approach is to provide investors of the contracting parties with a high level of certainty and predictability regarding the international legal framework applicable to their investments, which thereby establishes a stable environment in which they can conduct their businesses.

Among the BITs under review, the prevailing trend has been to specify that the initial period for which the treaty shall be in force will be 10 years. Among the agreements following this approach is the BIT between Argentina and New Zealand (1999). However, a significant number of agreements provide for a longer initial period of application (15 years), such as the BIT between Finland and the Philippines (1998). Other treaties provide in principle that the BIT shall remain in force indefinitely until one contracting party notifies the other of its intention to terminate it. An example is the BIT between the Democratic People's Republic of Korea and Thailand (2002) (table 8).

Most BITs provide that after the initial fixed period has ended, each party may terminate the treaty, usually with one year's written notice (table 8). However, some agreements, such as the BIT between Costa Rica and Spain (1997), provide for a different period of notice, for example six months. Most BITs also state that if the agreement is not terminated at the end of the initial fixed term, it shall continue to be in force.

**Table 8. Examples of final provisions**

BIT between Argentina and New Zealand (1999)	BIT between Finland and the Philippines (1998)	BIT between the Democratic People's Republic of Korea and Thailand (2002)
<p style="text-align: center;">“Article 14 Final provisions</p> <p>(1) The Contracting Parties shall notify each other in writing when the constitutional requirements for the entry into force of this Agreement have been fulfilled. This Agreement shall enter into force on the thirtieth (30th) day from the date of the later notification.</p> <p>(2) This Agreement shall remain in force for a period of <b>ten years</b>. It shall remain in force thereafter until one of the Contracting Parties gives one year's written notice of termination through diplomatic channels of its intention to terminate.</p> <p>(3) In respect of investments made prior to the date when the notice of termination of this Agreement becomes effective, the provisions of Articles 1 to 13 shall remain in force for a further period of fifteen years from that date.” (emphasis added)</p>	<p style="text-align: center;">“Article 12 Final clauses</p> <p>1) The Contracting Parties shall notify each other when the constitutional requirements for the entry into force of this Agreement have been fulfilled. The Agreement shall enter into force on the thirtieth day after the latter notification.</p> <p>2) This Agreement shall remain in force <b>fifteen years</b>. Thereafter, it shall remain in force until one of the Contracting Parties gives one year's prior written notice of termination through diplomatic channels.” (emphasis added)</p>	<p style="text-align: center;">“Article 14 Entry into force, duration and termination</p> <p>1. Each Contracting Party shall notify the other in writing of the completion of the procedures required in its territory for the entry into force of this Agreement. This Agreement shall enter into force on the date of the latter of the two notifications for an initial period of ten years.</p> <p>2. Thereafter, this Agreement shall <b>remain in force indefinitely</b> unless either Contracting Party notifies the other Contracting Party in writing of its intention to terminate it. The termination of this Agreement shall become effective one year after notice of termination has been received by the other Contracting Party. In respect of investments made prior to the date when the termination of this Agreement becomes effective, the provisions of this Agreement shall remain in force for a period of fifteen years.” (emphasis added)</p>

Among the BITs examined, one can discern two different approaches regarding the specification of the duration of the treaty after the initial fixed term has expired. While some BITs state that the treaty shall continue to be in force indefinitely — always subject to the right of either party to terminate the agreement by prior written notice — others provide that the treaty shall continue to be in force for additional fixed terms. In this regard, there has been a shift in the prevailing trend between the BITs of the last decade and those concluded until the mid-1990s. In the earlier period, most BITs used to establish fixed terms for renewal of the agreements, most commonly 10 years. During the review period, however, the prevailing trend has been to allow the agreements to remain in force indefinitely.

Regardless of whether BITs follow the fixed-term or indefinite approach to delimit the duration of the treaty, a significant number of agreements provide that investments covered under the BIT shall continue to be protected for a specific time even after the treaty has been terminated. The BIT between Argentina and New Zealand (1999) is an example of this approach (table 8). Once again, the rationale is to provide investors of the contracting parties with a predictable legal environment for their investments.

\* \* \*

In conclusion, BITs concluded in the review period have consolidated the traditional approaches to delimit the scope of application of the agreement; as in the past, they use separate definitions of “investment”, “investor” and “territory” for that purpose, and also specify their application in time. The most important new development has to do with the definition of an “investment”. Whereas most BITs of the last decade continue to use a broad, asset-based definition, some more recent agreements have made an effort to delimit its scope more precisely.

### **C. Admission and establishment of investment**

The issue of admission and establishment refers to the entry of investments of investors of a contracting party into the territory of another contracting party. According to customary international law, countries have the right to regulate the admission of foreign investors and their investments in their territories. Most countries refrain from granting foreign nationals and companies an unrestricted right to invest in their economies (UNCTAD 1999b).

Access limitations imposed on foreign investment have been justified on economic, social, political or national security grounds. The negotiation of BITs has evolved within this context. Two basic models are currently used. One makes the admission and establishment of foreign investment subject to the domestic laws of the host country (called the “admission clause” model), and the other grants foreign investors a right of establishment, although not in an absolute manner (hereinafter called the “right of establishment” model).<sup>28</sup>

As will be explained below, most BITs have not been conceived as instruments to provide foreign investors with a right of establishment. Rather, these agreements only impose a duty on the contracting parties to admit foreign investment in accordance with their national legislation. However, as will be explained below, recent BITs have applied different techniques and modalities to deal with the issue of admission and establishment of foreign investment.

#### **1. The use of the “admission clause”**

The overwhelming majority of BITs concluded since 1995 admit investments of investors of the other contracting party only if such investments conform to the host country's legislation. This is the so-called admission clause. It allows the host country to apply any admission and screening mechanism for foreign investment that it may have in place and therefore to determine the conditions on which foreign investment will be allowed to enter the country.

Another implication of the admission clause is that, regardless of whether the host country maintains any admission and screening mechanism for foreign investment — and unless the BIT states otherwise — there is no obligation on the part of the host country to eliminate discriminatory legislation affecting the establishment of foreign investment. For example, if the domestic legislation reserves certain economic activities to national investors or even to foreign investors of a particular nationality, this is part of the legal context that foreign investors have to respect when admitted to the host country.

The language used in the drafting of admission clauses varies among treaties. For example, some BITs, such as the one between Ethiopia and the Russian Federation (2000), specify only that investments of investors of the parties “*shall be admitted in accordance with their laws and regulations*”. Other BITs, such as the one between Bahrain and Thailand (2002), address the issue of admission by delimiting the scope of application of the agreement and specifying that, for the investment to be admitted into the host country, written approval may be required. Other BITs, for example the one between Australia and Egypt (2001), stress the fact that the host country is not binding its legislation regarding investment entry — legislation which may vary “*from time to time*” — and indicate that the admission may be contingent on the investment policies adopted by the host country (table 9).

**Table 9. Examples of admission clauses**

BIT between Ethiopia and the Russian Federation (2000)	BIT between Bahrain and Thailand (2002)	BIT between Australia and Egypt (2001)
<p>“Article 2.1. Promotion and Protection of Investments</p> <p>1. Each Contracting Party shall encourage and create favourable conditions for Investors of the other Contracting Party to invest in its territory and <b>admit such investments in accordance with its laws and regulations.</b>” (emphasis added)</p>	<p>“Article 2. Scope of Application</p> <p>1. The benefits of this Agreement shall apply to the investments by the investors of one Contracting Party in the territory of the other Contracting Party which is <b>specifically approved in writing</b> by the competent authority in accordance with the laws and regulations of the latter Contracting Party.” (emphasis added)</p>	<p>“Article 3 Promotion and protection of investments</p> <p>1. Each Party shall encourage and promote investments in its territory by investors of the other Party and shall, in accordance with its laws and investment policies <b>applicable from time to time</b>, admit investments.” (emphasis added)</p>

In a recent arbitration case, the issue was raised whether the reference to the domestic laws and regulations in the admission clause allows the host country to condition the basis on which a foreign investment enters its market. In particular, it was argued that this reference could serve to place an investment within the exclusive jurisdiction of the host country. The arbitration tribunal rejected this reasoning. It held that such an interpretation would defeat the purpose of the BIT with regard to establishing a neutral and independent forum for dispute resolution.<sup>29</sup>

## 2. Right of establishment

Besides those BITs containing an admission clause, there is a second category of agreements that grant certain rights of entry to investors of the other contracting party.

### a. The granting of national treatment and most-favoured nation treatment

This approach consists in providing foreign investors with national treatment and MFN treatment not only once the investment has been established, but also with respect to the establishment. This means that investors of one party will receive treatment not less favourable with regard to investing in the territory of the other party than domestic investors and investors of any other third country (UNCTAD 1999d). These treaties therefore also aim at liberalizing investment flows.

BITs designed for the purpose of ensuring the free entry of foreign investment into the territory of the host country may contain country-specific reservations. The contracting parties thus retain some degree of flexibility to control the admission of foreign investment from the other party, usually by allowing for the inclusion of a list of industries, activities or laws and regulations to which the obligations to grant national treatment and MFN treatment in the pre-establishment phase do not apply.

The use of this approach was traditionally limited to BITs concluded by the United States and, after the mid-1990s when the NAFTA had entered into force, to agreements concluded by Canada.<sup>30</sup> However, during the last 10 years other nations, such as Japan, have adopted this method. As a result, a growing number of developing countries actually apply two different BIT models, depending on who their treaty partners are: the “admission clause” model (mostly in BITs with European countries) and the “right of establishment” model (mainly in treaties concluded by the United States and Canada).

Within the category of agreements granting establishment rights, different techniques have been used to deal with host country measures that do not conform to the national treatment and MFN obligations. BITs negotiated by the United States and Canada during the end of the 1990s and during the beginning of this century often used to have only one annex listing the sectors where the host country reserves the right not to grant national treatment and MFN treatment in the pre-establishment phase. In those agreements, once a sector is included in the annex, the contracting party concerned is free to maintain or adopt new non-conforming measures. It should be noted that some agreements, such as the BIT between Canada and Costa Rica (1998), provide for the possibility of making reservations only with respect to the investor or the investment in the pre-establishment phase, while other agreements, such as the BIT between Azerbaijan and the United States (1997), also allow the contracting parties to refrain from granting national treatment or MFN treatment to established investments, unless this amounts to a full or partial forced disinvestment (table 10).

**Table 10. Examples of provisions granting NT and MFN treatment in the pre-establishment phase subject to an annex of reservations**

BIT between Azerbaijan and the United States (1997)	BIT between Canada and Costa Rica (1998)
<p>“Article II</p> <p>1. With respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of covered investments, each Party shall accord treatment no less favorable than that it accords, in like situations, to investments in its territory <b>of its own nationals or companies</b> (hereinafter “national treatment”) or to investments in its territory <b>of nationals or companies of a third country</b> (hereinafter “most favored nation treatment”), whichever is most favorable (hereinafter “national and most favored nation treatment”). Each Party shall ensure that its state enterprises, in the provision of their goods or services, accord national and most favored nation treatment to covered investments.</p> <p>2. (a) A Party may adopt or maintain <b>exceptions to the obligations of paragraph 1</b> in the sectors or with respect to the matters specified in the Annex to this Treaty. In adopting such an exception, a Party may not require the divestment, in whole or in part, of covered investments existing at the time the exception becomes effective [...]” (emphasis added)</p>	<p>“Article III</p> <p>Establishment of Investment</p> <p>1. Each Contracting Party shall permit establishment of a new business enterprise or acquisition of an existing business enterprise or a share of such enterprise by investors or prospective investors of the other Contracting Party on a basis no less favorable than that which, in like circumstances, it permits such acquisition or establishment by:</p> <p><b>investors or prospective investors of any third State;</b></p> <p><b>its own investors or prospective investors.</b></p> <p>For the purpose of this Agreement, “prospective investor” means any natural person or enterprise of one Contracting Party who actually has carried out concrete steps toward making an investment in the territory of the other Contracting Party.</p> <p>2. A Contracting Party may adopt or maintain <b>exceptions to the obligation stated in paragraph (1) above</b>, in the sectors, measures, or with respect to the matters specified in Sections I, II, III and VI of Annex I of this Agreement.” (emphasis added)</p>

More recently, BITs providing for national treatment and MFN treatment in the pre-establishment phase have used a more sophisticated approach to deal with reservations to those obligations.

One annex includes a list of *existing laws and regulations* which are inconsistent with one or several of the obligations in respect of which the contracting parties may adopt reservations. This is an annex of non-conforming measures, the effect of which is to allow the contracting parties to maintain the level of non-conformity existing between the domestic legislation of the contracting parties and the obligations of the BIT. Thus, once the BIT enters into force, parties may amend any of the non-conforming measures included in this annex, provided that the amendment does not decrease the conformity of the measure with the obligation concerned as it existed immediately before the amendment. An example is the 2004 Canadian model BIT:

“Article 9  
*Reservations and Exceptions*”

1. *Articles 3, 4, 6 and 7 shall not apply to:*
  - (a) **any existing non-conforming measure** that is maintained by
    - (i) a Party at the national level, as set out in its Schedule to Annex I, or
    - (ii) a sub-national government;
  - (b) the continuation or prompt renewal of any non-conforming measure referred to in subparagraph (a);
  - (c) an amendment to any non-conforming measure referred to in subparagraph (a) to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment, with Articles 3, 4, 6 and 7.” (emphasis added)

Recent BITs of Canada, Japan and the United States also envisage a second kind of annex, which comprises a list of economic activities or sectors where the contracting parties may maintain *or adopt new measures* inconsistent with one or several of the obligations of the BIT. Thus, in the areas or sectors included in this annex, parties are not only allowed to maintain any existing non-conforming laws or regulations, but also reserve their right to adopt new non-conforming measures, which may not have existed at the time of negotiations. This kind of annex is often known as annex of “future measures” or “precautionary reservations”. An example is the 2004 Canadian model BIT:

“Article 9  
*Reservations and Exceptions*”

[...]

2. *Articles 3, 4, 6 and 7 shall not apply to any measure that a Party adopts or maintains with respect to sectors, sub sectors or activities, as set out in its schedule to Annex II.”*

Other BITs, such as the one between Japan and Viet Nam (2003) include much more detailed provisions and allow new non-conforming measures only in “*exceptional circumstances*”.

“Article 6

1. *Notwithstanding the provisions of Article 2 or 4, each Contracting Party may maintain any exceptional measure, which exists on the date on which this Agreement comes into force, in the sectors or with respect to the matters specified in Annex II to this Agreement.*
2. *Each Contracting Party shall, on the date on which this Agreement comes into force, notify the other Contracting Party of all existing exceptional measures in the sectors or with respect to the matters specified in Annex II. Such notification shall include information on the following elements of each exceptional measure:*
  - (a) *sector and sub-sector or matter;*
  - (b) *obligation or article in respect of the exceptional measure;*
  - (c) *legal source of the exceptional measure;*
  - (d) *succinct description of the exceptional measure; and*
  - (e) *purpose of the exceptional measure.*

3. *Each Contracting Party shall endeavour to progressively reduce or eliminate the exceptional measures notified pursuant to paragraph 2 above.*
4. ***Neither Contracting Party shall, after the entry into force of this Agreement, adopt any new exceptional measure in the sectors or with respect to the matters specified in Annex II.***
5. *The provisions of paragraph 4 above shall not be construed so as to prevent a Contracting Party from amending or modifying any existing exceptional measure, provided that such amendment or modification does not decrease the conformity of the exceptional measure, as it existed immediately before the amendment or modification, with the provisions of Article 2 or 4.*
6. *In cases where a Contracting Party makes such amendment or modification, the Contracting Party shall, prior to the entry into force of the exceptional measure or, in exceptional circumstances, as soon thereafter as possible:*
  - (a) *notify the other Contracting Party of the elements of the exceptional measure as set out in paragraph 2 of this Article; and*
  - (b) *provide, upon request by that other Contracting Party, particulars of the exceptional measure to that other Contracting Party.*
7. ***Notwithstanding the provisions of paragraph 4 of this Article, each Contracting Party may, in exceptional financial, economic or industrial circumstances, adopt any exceptional measure in the sectors or with respect to the matters specified in Annex II, provided that such Contracting Party shall, prior to the entry into force of the exceptional measure:***
  - (a) *notify the other Contracting Party of the elements of the exceptional measure as set out in paragraph 2 of this Article;*
  - (b) *provide, upon request by that other Contracting Party, particulars of the exceptional measure to that other Contracting Party;*
  - (c) *allow that other Contracting Party reasonable time to make comments in writing;*
  - (d) *hold, upon request by that other Contracting Party, consultations in good faith with that other Contracting Party with a view to achieving mutual satisfaction; and*
  - (e) *take an appropriate action based upon the written comments made pursuant to subparagraph (c) of this paragraph or the results of the consultations held pursuant to subparagraph (d) above.” (emphasis added)*

From the perspective of the investor, BITs providing for national treatment and MFN treatment in the pre-establishment phase are more advantageous than those including an admission clause, and thus provide these rights only to established investment. Within this context, a question of interaction of BITs arises. In a hypothetical scenario, country A negotiates with country B a BIT providing for a right of establishment. Considering that most BITs contain an MFN clause, would this right need to be extended to all other investors of third countries with which country A has concluded a BIT limited to post-establishment protection? The relevance of this question becomes more pertinent as the number of countries negotiating BITs providing protection in both the pre- and post-establishment phases of the investment increases. Since the scope of legal obligations in those BITs with only an admission clause is confined to post-establishment treatment, the MFN clause included therein could not have the effect of “importing” a right of establishment from another treaty.

#### **b. The granting of most-favoured nation treatment only**

There are BITs that, despite containing an admission clause, also provide some rights to investments in the pre-establishment phase. An illustration of this approach is the BIT between Bangladesh and Japan (1998):

##### *“Article 2*

1. *Each Contracting Party shall, subject to its rights to exercise powers in accordance with the applicable laws and regulations, encourage and create favorable conditions for investors of the other Contracting Party to make investment in its territory, and, subject to the same rights, shall admit such investment.*

2. *Investors of either Contracting Party shall within the territory of the other Contracting Party be accorded treatment no less favorable than that accorded to investors of any third country in respect of matters relating to the admission of investment.*" (emphasis added)

Paragraph 1 of this provision does not provide investors with any right of entry into the host country beyond the rights included in the domestic legislation of the parties. However, paragraph 2 grants investors of the contracting parties the right to receive the best treatment regarding admission that each of them grants to investors of any third country — that is, foreign investors receive MFN treatment in the pre-establishment phase. In the above example, considering that Japan has concluded BITs providing for national treatment and MFN treatment in the pre-establishment phase with countries such as the Republic of Korea and Viet Nam, Bangladeshi investors would be entitled to the guarantees that Japan provides to Republic of Korea or Vietnamese investors pursuant to the respective BITs.

\* \* \*

Summarizing the recent trends in BITs, the prevailing approach is to make the question of entry and establishment subject to national laws. However, an increasing number of BITs provide national treatment and MFN treatment in the pre-establishment phase — perhaps as a response to the fact that the protection provided by traditional BITs is becoming commonplace. In the global economy, where more goods and services are delivered to foreign markets through international production than through international trade, and where patterns of international production of manufactures as well as international trade in services — most of which need commercial presence in order to be effectively provided — are increasing in importance, it is not surprising that international investors seek better market access for their investments.

#### D. Investment promotion

Most of the BITs reviewed do not specify any promotional activities that should be undertaken by the Governments of the BIT partners to encourage investment flows between the two countries, either as host or home countries. The approach to promotion of foreign investment taken by BITs is mainly indirect, relying in the first place on their protection provisions to create a favourable investment climate. This in turn is expected to deliver FDI flows (UNCTAD, 1998).<sup>31</sup> Thus, as in earlier practice, and in spite of BITs' clearly stated objective of promoting FDI flows between the countries, there is only a vague and general commitment of the contracting parties to "encourage" or "promote" investment, usually formulated in connection with the preamble, where the language tends to be hortatory in nature, or with the admission provisions (table 11) (see also sections A and C above).

Table 11. Examples of investment promotion provisions

BIT between Australia and Egypt (2001)	BIT between Spain and Uzbekistan (2003)	BIT between Hungary and India (2003)
<p>"Preamble</p> <p>Considering that investment relations <b>should be promoted</b> and economic co-operation strengthened in accordance with the internationally accepted principles of mutual respect for sovereignty, equality, mutual benefit, non-discrimination and mutual confidence; [...]" (emphasis added)</p>	<p>"Article 2 Promotion and Admission of Investments</p> <p>1. Each Contracting Party <b>shall in its territory promote</b>, as far as possible, investments by investors of the other Contracting Party. Each Contracting Party shall admit such investments in accordance with its laws and regulations. " (emphasis added)</p>	<p>"Article 3 Promotion and Protection of Investments</p> <p>1. Each Contracting Party <b>shall encourage and create favourable conditions</b> for investors of the other Contracting Party to make investments in its territory and admit such investments in accordance with its laws and regulations." (emphasis added)</p>

Occasionally, a few recent BITs go a step further to require the parties to exchange information on investment opportunities in each country with a view to increasing investment flows. This language can be



found in the provisions related to transparency (see section J below) and in the institutional mechanism creating a joint commission to follow up on the application and interpretation of the treaty. However, in a few BITs, separate provisions on the exchange of information have been included. An example is the BIT between Mexico and Argentina (1996), which provides as follows:

*“Article 7: Exchange of Information*

*With the intention to increase significantly the reciprocal participation in investments, the Contracting Parties will inform each other in a detailed manner concerning especially*

- a. **investment opportunities;***
- b laws, regulations and decrees that directly or indirectly concern foreign investments, including, among others, exchange controls, monetary and fiscal regimes; and*
- c. performance of foreign investments in their respective countries.” (emphasis added) (non-official translation from Spanish)*

Similarly, some BITs include requirements to facilitate the granting of work permits, visas, licences and authorizations in connection with investment activities under the investment promotion provisions. An example is the BIT between Bolivia and the Republic of Korea (1996), which states that:

*“Article 2: Promotion and Reception of Investments*

*When a Contracting Party shall have admitted an investment on its territory, it shall grant the necessary permits in connection with such an investment and with the carrying out of licensing agreements and contracts for technical, commercial or administrative assistance. Each Contracting Party shall, whenever needed, issue, as far as possible, the necessary authorizations concerning the activities of consultants and other qualified persons of foreign nationality related to investment.”*

In other BITs, this language is included under a separate article on the entry and sojourn of personnel (see subsection I.2 below).

Moreover, a few BITs mention the granting of incentives as a way to encourage and to promote investments between the contracting parties. The BIT between Finland and Kuwait (1996), for example, states:

*“Article 2:  
Promotion of Investments*

*Each Contracting State shall endeavour to take the necessary measures **for granting of appropriate facilities, incentives and other forms of encouragement** for investments made by investors of the other Contracting State.” (emphasis added)*

Other BITs go even further by prescribing the establishment of representation offices in the other contracting party. For example, the BIT between Croatia and Denmark (2000) states as follows:

*“Article 2  
Promotion and Protection of Investments*

- 1. Each Contracting Party shall admit investments by investors of the other Contracting Party in accordance with its legislation and administrative practice and encourage such investments, **including facilitating the establishment of representative offices.**” (emphasis added)*

Some of these investment promotion efforts can also be seen in the context of home country measures, namely the proactive engagement of home countries to promote and facilitate outward investment by their firms, especially in developing countries (UNCTAD 2000b). Most of the BITs reviewed do not specify any

promotional activities, beyond the ones described above, that should be undertaken by Governments to encourage outward investment flows between the two BIT partners.

### E. General standards of treatment

Investment agreements contain obligations specifying the treatment that the contracting parties are required to provide to the investment once it has been established. One can distinguish between general treatment standards, that is standards relating to all aspects of the existence of a foreign investment in a host country, and specific treatment standards addressing particular issues (Vandeveldel, 1992).

Within the category of general standards of treatment, a further differentiation can be made. First, there are “absolute standards” of treatment, so called because they are non-contingent. They establish the treatment to be accorded to the investment without referring to the manner in which other investments are treated. Examples of absolute standards are the provisions on fair and equitable treatment, full protection and security, expropriation and the transfer of funds.<sup>32</sup>

A second category relates to “relative standards” of treatment. They define the required treatment to be granted to investment by reference to the treatment accorded to other investment. National treatment and MFN treatment are the relative standards par excellence. Thus, in the case of national treatment, reference must be made to the treatment of nationals of the host country. Similarly, in determining the content of the MFN standard, reference must be made to the treatment granted to investments from the “most favoured nation” (UNCTAD 1999d, 1999e, 1999f).

Continuing with the traditional trend, most BITs under review provide both categories of standards, albeit with significant variations.

#### 1. Absolute standards: Fair and equitable treatment, full protection and security, and the minimum standard of treatment according to customary international law

BITs usually include one or several general principles that, together or individually, are intended to provide overall criteria by which to judge whether the treatment given to an investment is satisfactory, and to help interpret and clarify how more specific provisions should be applied in particular situations (UNCTAD 1998). Fair and equitable treatment is one of those general principles. It provides a basic standard, detached from the host country’s domestic law, against which the behaviour of the host country vis-à-vis foreign investments can be assessed.

Numerous investment instruments combine the fair and equitable treatment standard with other legal principles that may have their own specific content and historical origin, such as the principles of *full protection and security* and *non-discrimination*.<sup>33</sup> While some treaties guarantee only fair and equitable treatment, other BITs bundle the three standards — or sometimes only two of them — and include them in one single article (table 12).

Although clauses providing foreign investment with fair and equitable treatment are widespread in IIAs, the standard itself lacks a precise meaning. Consequently, this principle has raised important questions, mostly in the context of the application of NAFTA’s Chapter 11, but — more recently — also in connection with BITs. The discussion has focused on the issue of the nature and content of the commitment.<sup>34</sup>

According to some scholars, the obligation to grant foreign investment “*fair and equitable treatment*” is not different from the obligation to treat the investment in accordance with the international minimum standard. The latter, so it is argued, is part of customary international law, which in turn comprises a bundle of international legal principles (see below).<sup>35</sup> According to other scholars, however, “*fair and equitable treatment*” means something different from the international minimum standard. On this view, the term “fair and equitable treatment” should be given its plain meaning. This results in a case-by-case application of a test based on equity in order to determine whether the standard has been infringed.<sup>36</sup>

Table 12. Examples of provisions on absolute standards of protection

BIT between Algeria and Indonesia (2000)	BIT between Brazil and the Netherlands (1998)	BIT between China and Qatar (1999)
<p style="text-align: center;">“Article II Promotion and Protection of Investment</p> <p>[...]</p> <p>2. Investments of investors of either Contracting Party shall at all times be accorded <b>fair and equitable treatment</b> and shall enjoy <b>adequate protection and security</b> in the territory of the other Contracting Party.” (emphasis added)</p>	<p style="text-align: center;">“Article 3</p> <p>1) Each Contracting Party shall ensure <b>fair and equitable treatment</b> of the investments of investors of the other Contracting Party and shall not impair, <b>by unreasonable</b> or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those investors. Each Contracting Party shall accord to such investments <b>full security and protection.</b>” (emphasis added)</p>	<p style="text-align: center;">“Article 3</p> <p>1. Investments and activities associated with investments of investors of either Contracting Party shall be accorded <b>fair and equitable treatment</b> and shall <b>enjoy protection</b> in the territory of the other Contracting Party.” (emphasis added)</p>

The practical implications of following one approach rather than the other could be significant.<sup>37</sup> If the fair and equitable standard were part of the international minimum standard of treatment, the test whether this principle has been violated would entail an objective test. The standard may have to be based on the existing body of customary international law of State responsibility for injury to aliens.

It is argued that under customary international law, for a country to violate the minimum standard of treatment of aliens requires a conduct by the Government amounting to gross misconduct, manifest injustice, an outrage, bad faith or wilful neglect of duty.<sup>38</sup> Consequently, a breach of this obligation will probably be found in fewer cases than if fair and equitable treatment is associated with higher standards. From the perspective of the host countries, this would mean that the obligation to grant foreign investment fair and equitable treatment would not significantly impair the flexibility and discretion of Governments to regulate and to pursue their public policy objectives. On the other hand, the three NAFTA contracting parties have accepted that the standard evolves and is not frozen in application to the types of circumstances contemplated in the “Neer” case.<sup>39</sup>

The outcome of applying the fair and equitable standard under the semantic approach could be very different. In this view, fair and equitable treatment would be understood as a standard of equity or fairness based on the “plain meaning” of the term. The test whether a country has breached the obligation would therefore be to a greater extent subjective than in the case of the international minimum standard — at least as long as there is not yet enough case law that would give the “plain meaning” approach a more precise content.

Following this semantic interpretation of the standard could entail establishing a low threshold for breaching the obligation. It would, in principle, suffice that the host country commits an action found to be *unfair* or *non-equitable* in the view of the arbitral tribunal. This approach therefore has the potential to make numerous governmental regulatory actions inconsistent with the obligations of the BIT, regardless of whether those measures are being adopted and implemented on a non-discriminatory basis.

Interpreting the fair and equitable treatment standard according to its plain meaning has another significant implication. Given that the violation of any other obligation included in the BIT would mean that the host country has somehow mistreated the foreign investor, it could also constitute a violation of the fair and equitable treatment standard.<sup>40</sup>

During the review period, the content of the fair and equitable treatment standard has been mostly contested in NAFTA’s Chapter 11 arbitrations, where arbitral tribunals were called upon in several cases to address the scope and content of NAFTA’s Article 1105.<sup>41</sup> Tribunal interpretations varied, which added to the fact that some of the interpretations of this provision were strongly opposed by all NAFTA contracting

parties. This prompted the intervention of the NAFTA Free Trade Commission. On 31 July 2001, this commission, which is composed of the trade ministers of the three contracting parties, issued a Note of Interpretation stating, among other aspects, that the fair and equitable treatment standard as set out in NAFTA's Article 1105 did not entail any treatment beyond that established by customary international law.<sup>42</sup>

Potential controversies as to the content of the standard can be minimized through the specific text in the BIT. Some BITs contain more precise language than others, and thus the room allowing for different interpretations of the content of the fair and equitable treatment standard may vary significantly among agreements. A survey of the BITs concluded during the last decade makes it possible to distinguish seven different categories.<sup>43</sup>

First, there are a significant number of BITs that grant covered investments “*fair and equitable treatment*” without making any reference to international law or to any other criteria to determine the content of the standard. An example of this trend is the BIT between Cambodia and Cuba (2001):

“*Article II*  
*Promotion and Protection of Investments*”

[...]

*2. Investments of investors of either Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy adequate protection and security in the territory of the other Contracting Party.”*

In this category of BITs, the specific content of the obligation remains open. Clarifications would have to be made on a case-by-case basis.

A second group of BITs explicitly state that such treatment shall not be less favourable than national treatment or MFN treatment granted to the investment or the investor concerned. The BIT between Bangladesh and the Islamic Republic of Iran (2001) demonstrates this approach:

“*Article 4*  
*Protection of Investments*”

*Investments of natural and legal persons of either Contracting Party effected within the territory of the other Contracting Party, shall receive the host Contracting Party's full legal protection and fair treatment **no less favourable than that accorded to its own investors or to investors of any third State, whichever is more favorable.***” (emphasis added)

This approach merges in one single clause the fair and equitable treatment principle — an absolute standard of protection — with the national treatment and MFN treatment standards, which are relative parameters of treatment. Furthermore, by linking these two kinds of standards and by providing that the fair and equitable treatment shall in no case be less favourable than national treatment or MFN treatment, the contracting parties indicate that they do not wish to see the fair and equitable treatment standard limited to the international minimum standard.

A third group of BITs add to the obligation to grant fair and equitable treatment the duty to abstain from impairing the investment through unreasonable or discriminatory measures. The BIT between Hungary and Lebanon (2001) illustrates this frequently used approach:

“*Article 2*  
*Promotion and Protection of Investments*”

[...]

*2. Investments and returns of investors of either Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party. Each Contracting Party **shall refrain from impairing by unreasonable or discriminatory measures** the management, maintenance, use, enjoyment, extension, sale or liquidation of such investments.”* (emphasis added)

A fourth category of BITs links the fair and equitable standard to the principles of international law. Among the agreements following this method is the BIT between France and Mexico (1998):

“Article 4  
*Protection and treatment of investments*

*1. Either Contracting Party shall extend and ensure fair and equitable treatment **in accordance with the principles of International Law** to investments made by investors of the other Contracting Party in its territory or in its maritime area, and ensure that the exercise of the right thus recognized shall not be hindered by law or in practice [...].” (emphasis added)*

Linking the fair and equitable treatment standard to the principles of international law removes the possibility of interpreting the provision using the semantic approach. Furthermore, this link implies that the fair and equitable treatment standard cannot be applied separately from the principles of international law, which would include customary international law on State responsibility in respect of aliens.

A fifth category of BITs also links the fair and equitable treatment standard to the principles of international law. However, this group of agreements includes additional language so broad that it appears to go beyond the international minimum standard of treatment. An example is the BIT between France and Uganda (2002), which states:

“Article 3  
*Fair and equitable treatment*

*Either Contracting Party shall extend **fair and equitable treatment in accordance with the principles of International Law** to investments made by nationals and companies of the other Contracting Party on its territory or in its maritime area, and shall ensure that the exercise of the right thus recognized shall not be hindered by law or in practice. **In particular, though not exclusively, shall be considered as de jure or de facto impediments to fair and equitable treatment any restriction to free movement, purchase and sale of goods and services, as well as any other measures that have a similar effect [...].” (emphasis added)***

In this example, the clause states that fair and equitable treatment is not equivalent to a plain fairness standard, but rather is a commitment that has to be interpreted within the framework of the principles of international law. Nevertheless, in its second sentence, the article states that “*any restriction*” — without any qualification of arbitrariness — affecting the free movement and trade of goods and services shall be considered an infringement of the fair and equitable treatment standard. This language is so broad that it allows practically any regulatory measure in these areas having a restrictive effect to be considered a violation of the fair and equitable treatment standard. In addition, the wording of the clause leaves very little discretion to a potential arbitral tribunal and explicitly states that if measures of the kind referred to are adopted, it “*shall*” be considered a violation of the standard.

If this approach can be deemed to provide a very extensive scope to the fair and equitable treatment standard, it is also true that among recent BITs one can find methods at the other end of the spectrum. A sixth approach used to address the fair and equitable standard is to make the guarantee contingent on the domestic legislation of the host country. A case in point is the BIT between the countries of the Caribbean Common Market (CARICOM) and Cuba (1997):

“Article IV  
*Fair and equitable treatment*

*Each Party shall ensure fair and equitable treatment of Investments of Investors of the other Party **under and subject to national laws and regulations.**” (emphasis added)*

A seventh group of agreements provides for a more precise approach regarding the scope of the fair and equitable treatment standard. It comprises some recent BITs of the United States, and the 2004 Canadian model BIT. These agreements contain a provision on the minimum standard of treatment, establishing the obligation of the contracting parties to accord covered investments treatment in accordance with customary international law. They include within the latter the notions of fair and equitable treatment and full protection and security, and define each of these terms within the same article.

Drafters of this kind of agreement have taken into account the issues discussed in recent NAFTA arbitrations. Elaborating on the Note of Interpretation issued by the Free Trade Commission, this new approach not only sets out the provision to focus on the "*customary international law minimum standard of treatment of aliens*", but also defines the content of more specific standards of treatment subsumed within the former, such as fair and equitable treatment and full protection and security. An illustration of this trend is the BIT between the United States and Uruguay (2005):

“Article 5:  
*Minimum Standard of Treatment*<sup>1</sup>”

1. *Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.*
2. *For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:*
  - (a) *“fair and equitable treatment” includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and*
  - (b) *“full protection and security” requires each Party to provide the level of police protection required under customary international law.*
3. *A determination that there has been a breach of another provision of this Treaty, or of a separate international agreement, does not establish that there has been a breach of this Article.*

<sup>1</sup> *Article 5 shall be interpreted in accordance with Annex A.*

*Annex A  
Customary International Law*

*The Parties confirm their shared understanding that “customary international law” generally and as specifically referenced in Article 5 and Annex B results from a general and consistent practice of States that they follow from a sense of legal obligation. With regard to Article 5, the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens.” (emphasis added)*

The language of this clause is self-explanatory. The debate regarding the fair and equitable treatment clause in the context of Chapter 11 of NAFTA has shown the risks of including language in BITs providing for unqualified fair and equitable treatment of foreign investment. The wording of this clause might be broad enough to be invoked in respect of virtually any adverse treatment of an investment, thus making the fair and equitable treatment provision among those most likely to be relied upon by an investor in order to bring a claim under the investor–State dispute settlement proceedings.

It is therefore not surprising that some countries have begun to consider redrafting their BIT models to clarify the scope and content of the fair and equitable treatment standard. This fact, in turn, may also become a precedent for current and future BIT negotiations, as well as for the application of those other existing BITs that provide for unqualified fair and equitable treatment. The clarification example might lead some to argue that those BITs providing for unqualified fair and equitable treatment follow the “plain meaning” approach. The basis for such an argument could be that if the contracting parties had intended something different, they

would have explicitly stated that the fair and equitable treatment standard does not grant investment protection beyond customary international law, assuming that such law exists in this area. Thus, it is likely that the fair and equitable treatment standard will continue to be a focal point of debate on international investment law.

## 2. Relative standards: Most-favoured-nation treatment and national treatment

In addition to the absolute standards of treatment discussed in the previous section, BITs provide for relative standards of treatment, namely national treatment and MFN treatment. BITs concluded since 1995 address these principles in multiple ways, raising a number of issues both for developing and developed countries.

### a. National treatment

National treatment in a BIT context means the obligation of contracting parties to grant investors of the other contracting party treatment no less favourable than the treatment they grant to investments of their own investors. The effect is to create a level playing field between foreign and domestic investors in the relevant market (UNCTAD 1999e).

Two different sets of questions arise regarding this standard. The first relates to the scope of the national treatment obligation — that is, to what should national treatment apply? As will be explained below, BITs approach this issue in different ways. The second set of questions relates to the manner in which the national treatment standard is to apply in practice.

#### (i) Scope of the national treatment standard

Not all BITs concluded during the review period address the scope of the national treatment standard in the same manner. A first group does not deal with the issue at all. The second category of BITs — which comprises by far the majority — does provide national treatment, but limits its coverage to established investments only. A third group comprises those agreements that provide national treatment to the investors in the pre- and post-establishment phase. Each of these approaches has different implications and raises other, more specific issues.

##### 1. *Agreements with no national treatment standard*

As mentioned before, a group of BITs refrains from granting the national treatment standard to any covered investments or investors.<sup>44</sup> These agreements usually limit their general protection standards to fair and equitable treatment and MFN treatment. This might allow contracting parties to treat their domestic investors more favourably.

Most countries that have subscribed to this kind of agreement have concluded at least one other BIT containing the national treatment standard. Consequently, given that all BITs refraining from granting national treatment nevertheless contain an MFN clause, the question arises whether investments covered by the former agreements might nevertheless be entitled to national treatment.<sup>45</sup>

##### 2. *Agreements with national treatment applying to established investment*

A second category of BITs includes the national treatment standard, but grants non-discriminatory treatment only after the investment has entered the host country. Focused on investment protection rather than on liberalization of investment flows, most BITs under review fall within this group. The typical formulation is to provide national treatment to investments covered by an agreement once it has been admitted into the host country according to the latter's domestic laws and regulations. To achieve this result, all BITs falling within this category contain an admission clause limiting the scope of the protection standards in the agreements.<sup>46</sup> Furthermore, those BITs providing for national treatment usually also include the MFN principle — the other relative protection standard (table 13).

Table 13. Examples of national treatment provisions

BIT between Mauritius and Zimbabwe (2000)	BIT between the Russian Federation and Thailand (2002)
<p style="text-align: center;">“Article 4 Treatment of Investments</p> <p>[...] (2) Each Contracting Party shall accord to the <b>investments</b> of investors of the other Contracting Party made in its territory a treatment which is no less favourable than that accorded to investments <b>of its own investors or of investors of any third country</b>, if the latter is more favourable.” (emphasis added)</p>	<p style="text-align: center;">“Article 3 Treatment of Investments</p> <p>1. Each Contracting Party shall accord in its territory to <b>investments</b> made in accordance with its laws by investors of the other Contracting Party treatment no less favourable than that it accords to investments <b>of its own investors or to investments of investors of any third State</b>, whichever is more favourable.</p> <p>2. Each Contracting Party shall in its territory accord <b>investors</b> of the other Contracting Party, as regards management, maintenance, use, enjoyment or disposal of their investments, treatment no less favourable than that which it accords to <b>its own investors or investors of any third State</b>, whichever is more favourable.” (emphasis added)</p>

Within this group of BITs, some agreements apply the standard only to the *investments*, while other agreements provide that national treatment shall also apply to the *investors* of the other party. An example is the BIT between the Russian Federation and Thailand (2002) in table 12. This BIT includes a further distinctive element as it also enumerates the kind of investment activities covered by the provision.

Some BITs go even one step further and define these investment or business activities in more detail. A case in point is the BIT between Bangladesh and Japan (1998):

*“Article 1*

[...]

6. *“The term “business activities in connection with the investment” includes:*
- (a) the maintenance of branches, agencies, offices, factories and other establishments appropriate to the conduct of business activities;*
  - (b) the control and management of companies established or acquired by investors;*
  - (c) the employment of accountants and other technical experts, executive personnel, attorneys, agents and other specialists;*
  - (d) the making and performance of contracts; and*
  - (e) the use, enjoyment or disposal, in relation to the conduct of business activities, of investment and returns.”*

Another group of BITs take a very different approach. They allow the host country to discriminate against foreign investment not only at the stage of entry, but also afterwards. These BITs therefore make the national treatment standard *contingent on the domestic legislation of the host country*. This gives host countries ample discretion to enact new legislation in favour of domestic investment. Examples of this approach can be found in the BITs between India and Indonesia (1999), and between Hong Kong (China) and New Zealand (1995) (table 14).

There is another method that constitutes an intermediary approach between the two alternatives. This approach allows all legislation non-consistent with the national treatment obligation to remain applicable after the BIT enters into force, but at the same time prohibits new non-conforming measures that would increase the degree of discrimination. An example is the BIT between China and the Netherlands (2001). It contains a protocol to the non-discrimination provision (Article 3), which reads as follows:



“[...] *Ad Article 3, paragraph 2 and 3*

*In respect of the People’s Republic of China, Paragraphs 2 and 3 of Article 3 do not apply to:*

- a) any existing non-conforming measures maintained within its territory;*
- b) the continuation of any non-conforming measure referred to in subparagraph a);*
- c) an amendment to any non-conforming measure referred to in subparagraph a) **to the extent that the amendment does not increase the non-conformity of the measure, as it existed immediately before the amendment, with those obligations.***

*It will be endeavoured to progressively remove the non-conforming measures.” (emphasis added)*

**Table 14. Examples of provisions illustrating national treatment granted in the post-establishment phase and conditioned to domestic laws and regulations**

BIT between India and Indonesia (1999)	BIT between Hong Kong (China) and New Zealand (1995)
<p style="text-align: center;">“Article 4 Treatment of Investments</p> <p>[...]</p> <p>3. Each Contracting Party shall, <b>subject to its laws and regulations</b>, accord to investment of investors of the other Contracting Party treatment no less favorable than that which is accorded to investments of its investors.” (emphasis added)</p>	<p style="text-align: center;">“Article 4 Treatment of Investments</p> <p>1. Neither Contracting Party shall in its area subject investments or returns of investors of the other Contracting Party to treatment less favourable than that which it accords to investments or returns of investors of any other State or, <b>subject to its laws and regulations</b>, that which it accords to investments or returns of its own investors.</p> <p>2. Neither Contracting Party shall in its area subject investors of the other Contracting Party, as regards their management, maintenance, use, enjoyment or disposal of their investments, to treatment less favourable than that which it accords to investors of any other State or, <b>subject to its laws and regulations</b>, that which it accords to investments or returns of its own investors.” (emphasis added)</p>

In addition to the general application of the national treatment standard in the post-establishment phase, some BITs consider it necessary to emphasize this principle with regard to a particular topic. This is the case of several BITs of Japan, which contain a clause underlining the application of the national treatment standard regarding access to courts and other administrative agencies. The BIT between Japan and the Russian Federation (1998) demonstrates this point.

“Article 4

*The investors of each Contracting Party shall be accorded on the territory of the other Contracting Party treatment not less favourable than the one accorded for the investors of such other Contracting Party or investors of any third country **in terms of access to the courts, administrative tribunals and agencies of any level of jurisdiction for the purpose of protecting and exercising their rights.***” (emphasis added)

### *3. Agreements with national treatment applying in the pre- and post- establishment phase*

BITs pursuing the liberalization of investment flows in parallel with investment protection usually extend the scope of the national treatment obligation – albeit with country-specific reservations – to the pre-entry phase. This means that foreign investors are entitled to be treated with regard to the making of

investment no less favourably than domestic investors in the host country. Section C.2. above explained in detail the different approaches used in recent BITs to address this issue.

## (ii) Application of the national treatment standard

The application of the national treatment standard raises two main questions, which may be clarified *ex ante* in BITs. First, what are the content and the meaning of this non-discrimination standard? And second, how should the standard apply in those contracting parties that have a federal system of government and thus different jurisdictions that might treat investors differently?

### 1. Content and meaning of the national treatment standard

For the application of the national treatment standard, it does not matter whether the difference in treatment is specifically provided for in a law or regulation of the host country — *de iure discrimination* — or is the consequence of a measure ostensibly non-discriminatory, but resulting in different treatment in fact — *de facto discrimination*.

Being a contingent standard of treatment, the specific content of the national treatment obligation is determined in relation to the treatment granted to domestic investments or investors. Thus, the application of the national treatment standard necessarily entails a comparative analysis between, on the one hand, the treatment granted by the host country to its domestic investments or investors and, on the other hand, the treatment granted by the same host country to the investments or investors of the other contracting party. Such analysis does not aim at determining whether the treatment is *identical*, but rather whether foreign investments or investors receive a treatment *no less favourable* than domestic investments or investors.

Among the BITs of the last decade, some explicitly state that the obligation to grant no less favourable treatment shall apply only when the investments or investors are "*in like circumstances*". An example is the BIT between Japan and Viet Nam (2003):

#### "Article 2

1. *Each Contracting Party shall in its Area accord to investors of the other Contracting Party and to their investments treatment no less favourable than the treatment it accords **in like circumstances** to its own investors and their investments with respect to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment, and sale or other disposal of investments (hereinafter referred to as "investment activities") [...]* (emphasis added)

This specification provides greater guidance for the application of the national treatment standard. The wording makes it clear that providing different treatment to foreign investments and investors, which in fact are not in the same circumstances as domestic investments or investors, would not violate the national treatment standard.

The inclusion of "*in like circumstances*" has led arbitral panels to adopt a "two-step" approach when determining whether a particular measure violates the national treatment standard. Several arbitral tribunals followed an analysis in which the tribunal first verified whether there were in fact differences in treatment between domestic and foreign investors or their investments. If a difference was found, the tribunal then addressed the issue of whether investors or investments were "*in like circumstances*". Such determination requires a factual analysis undertaken on a case-by-case basis.<sup>47</sup>

The application of the national treatment standard in the context of BITs entails different dynamics from the application of the same principle in connection with international trade in goods. Concerning the latter, a significant body of jurisprudence regarding the objective, nature and content of the national treatment standard has evolved under GATT and WTO dispute settlement procedures. In numerous cases, allegations that a country had not treated foreign goods as favourably as "*like*" domestic goods have been considered. One of the main avenues to address this question has been to determine whether the products

produced by the domestic industry and those manufactured by foreign suppliers are, in fact, substitutes in the marketplace. The processes and production methods to create a product, including their impact on the environment, have often been considered irrelevant for the determination of whether the products subject to comparison are in fact “like products”.<sup>48</sup>

Unlike in trade in goods, where tradable products in two or more different jurisdictions are produced, production facilities operate within the jurisdiction of the same host country in the case of inward foreign investment. Consequently, the nature of the foreign investor's production and business processes are much more likely to attract attention than in trade because of their direct impact in the host country. This difference has already been taken into consideration in several arbitral awards addressing national treatment claims.<sup>49</sup>

In several cases under NAFTA’s Chapter 11, arbitral tribunals have adopted an approach that provides scope for legitimate regulatory initiatives even if they treat domestic and foreign investors differently.<sup>50</sup> In determining whether foreign and domestic investors who were treated differently were in like circumstances, arbitral tribunals have asked whether the difference in treatment has been justified by a rational policy objective that is not based on a preference for domestic over foreign investors and whether it unduly undermines the investment-liberalizing objectives of NAFTA. If the difference in treatment could be justified on this basis, arbitral tribunals have found that foreign and domestic investors are not in like circumstances.<sup>51</sup>

## *2. Application of the national treatment standard in federal systems of government*

Under Article 29 of the Vienna Convention, a BIT — like any other treaty — is binding upon each party in respect of its entire territory, unless a different intention appears from the text of the agreement or is otherwise established. As explained in section B.3 above, most BITs provide that these agreements are applicable in the whole territory of the contracting parties, regardless of the particular political structure existing in the country concerned.

Thus, when a country assumes the obligation to grant national treatment, it applies not only at the national level, but also to subnational jurisdictions. However, in countries with federal systems of government, subnational jurisdictions may enact laws and regulations granting preferential treatment to investments or investors of that particular State, even when compared with out-of-State investments or investors from the same country. This raises the question as to whether, when a contracting party of a BIT having a federal system of government grants national treatment, the investments or investors of the other contracting party are entitled to national treatment entailing “best-in-State treatment” or only “best-out-of-State treatment”.

Most national treatment clauses in BITs do not indicate what should be understood by a party’s “own” investment or investors. However, among the BITs examined, some specify that national treatment be granted in one way or the other. For instance, the BIT between the United States and Uruguay (2005) provides that in the case of the United States, the national treatment standard does not consist in the best “in-State” treatment, but in the treatment granted by the State concerned to investment and investors of any other State part of the United States:

### *“Article 3 National Treatment*

- 1. Each Party shall accord to investors of the other Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.*
- 2. Each Party shall accord to covered investments treatment no less favourable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.*
- 3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a sub-national government, treatment no less favourable than the treatment accorded, in like*

*circumstances, by that sub-national government to investors, and to investments of investors, of the Party of which it forms a part.”* (emphasis added)

The 2004 Canadian model BIT takes a similar approach. It provides, at least in principle, that the national treatment standard shall apply on an “out-of-State” basis.

The scope of the national treatment standard in countries with a federal system of government is an aspect to which attention should be paid, especially if the other contracting party has only a national jurisdiction. Otherwise, there is a risk of having a national treatment clause with an asymmetrical scope of application.

#### **b. Most-favoured-nation treatment**

The MFN treatment standard means that investments or investors of one contracting party are entitled to treatment by the other contracting party that is no less favourable than the treatment the latter grants to investments or investors of any other third country.

The MFN standard ensures that investments or investors of contracting parties to a BIT receive the best treatment that each of them has granted to the investments or investors of any other third country. Thus the MFN standard establishes, at least in principle, a level playing field between all foreign investors protected by a BIT (UNCTAD 1999d). The MFN standard is also one of the key tools that smaller developing countries have at their disposal to benefit from the stronger bargaining power of third countries.

Most issues and questions relating to the MFN standard are the same as have arisen regarding the scope and application of the national treatment principle (see subsection (a) above).

As in the case of national treatment, not all recent BITs address the MFN standard in the same manner. However, unlike in the case of national treatment, all these BITs include, at least in principle, the MFN standard.

Regarding the scope of the clause, two groups can be distinguished. One category of BITs grants MFN treatment only after the investment has been admitted into the host country.<sup>52</sup> Another group provides MFN treatment in both the pre- and the post-establishment phase.<sup>53</sup>

Among the BITs granting MFN treatment *only in the post-establishment phase*, one can distinguish several categories.

There are BITs that, once the investment has been admitted, grant MFN treatment to all covered investments, with, however, some important exceptions (see below).<sup>54</sup> A second category of agreements limit MFN treatment to established investment permitted by domestic legislation. However, while there are a number of agreements that follow this approach with respect to national treatment, BITs conditioning MFN treatment on domestic legislation are very rare.<sup>55</sup> The BIT between Malaysia and Saudi Arabia (2000) is a case in point:

*“Article 3  
Most-Favoured Nation Provision*

1. *In accordance with its laws and regulations, each Contracting Party shall in its territory accord investments and returns of investors of the other Contracting Party treatment not less favourable than that which it accords to investments and returns of its own investors, or to investments and returns of investors of any third State whichever is the more favourable. [...]* (emphasis added)<sup>56</sup>

Another group of BITs grants established investments MFN treatment, and provides that no new non-conforming measures must be taken which did not exist at the date the BIT entered into force (“standstill” clause).<sup>57</sup>

As in the case of national treatment, the BITs under review follow different approaches regarding what is covered by the MFN clause once the investment has been admitted into the host country. Some BITs provide that MFN treatment applies only to investments of investors,<sup>58</sup> while others extend it to investors. In the latter case, the BITs state that the non-discrimination guarantee applies with respect to the management, maintenance, use, enjoyment and disposal of the investments.<sup>59</sup> As in the case of national treatment, the wording of practically all BITs suggests that the MFN standard applies to both *de iure* and *de facto* discrimination.

### (i) The MFN standard in relation to dispute settlement

The MFN standard has generated controversy in the wake of the *Maffezini v. the Kingdom of Spain* case.<sup>60</sup> It is related to the scope of the MFN standard, in particular whether the MFN clause in a BIT applies only to substantive obligations or also to dispute settlement procedures. The significant analysis of this standard in international jurisprudence until recently focused on its application in respect of substantive rights.<sup>61</sup> The Maffezini case has shown the importance of clearly delimiting the scope of application of the MFN standard. It caused some countries to adjust the text of the MFN clause in BIT negotiations. This aspect leads to the second issue, namely how recent BITs address the question of exceptions to the MFN principle.

The Maffezini case concerned a dispute relating to the alleged treatment by Spanish authorities of Emilio Agustin Maffezini, an Argentine national who invested in an enterprise for the production and distribution of chemical products in Galicia, Spain. Mr. Maffezini invoked the BIT between Argentina and Spain (1991) and initiated an international arbitral procedure before ICSID. According to the provisions of this BIT, the investor had to submit the claim first to domestic courts. The possibility of settling the dispute through international arbitration existed only if domestic tribunals had failed to resolve the dispute on its merits within an 18-month period. Given that Mr. Maffezini did not submit his claim to Spanish courts, Spain objected to the jurisdiction of the arbitration tribunal, arguing that Mr. Maffezini had failed to comply with the BIT between Argentina and Spain.

Mr. Maffezini admitted that he had not presented his claim to Spanish courts prior to its submission to ICSID. Nevertheless, he argued that the MFN clause in article 4 of the BIT between Argentina and Spain allowed him to invoke the dispute settlement provisions in the BIT between Chile and Spain (2003), which permits the investor to submit the dispute to ICSID arbitration without having to involve the domestic courts first. The MFN clause in the BIT between Argentina and Spain reads as follows:

*“Article 4  
Treatment*

[...]

2. ***In all matters subject to this Agreement***, this treatment shall be no less favourable than that extended by each Party to the investments made in its territory by investors of a third country. [...]" (non-official translation from Spanish, emphasis added)

Since this MFN clause explicitly refers to “*all matters subject to this Agreement*”, the tribunal found after elaborate reasoning that Mr. Maffezini was allowed to “import” the dispute settlement provisions of the BIT between Chile and Spain (2003) and thus avoid the requirement to submit his dispute to Spanish courts prior to initiating the case under ICSID.

The Maffezini case shows that the MFN standard does not apply automatically. Furthermore, additional important limitations to the application of the MFN clause became clear.

One is the *eiusdem generis* principle, according to which the MFN principle can cover only issues belonging to the same subject matter or the same category of subject matter to which the clause relates. Thus, for example, an advantage granted between two contracting parties in the framework of a transportation agreement cannot automatically be “imported” into the framework of a BIT.

Second, while recognizing that the MFN clause can be used for purposes of “importing” dispute settlement provisions from other investment agreements, the tribunal reasoned that the MFN standard cannot override public policy considerations envisaged by the contracting parties as crucial to their acceptance of the agreement:

*“62. Notwithstanding the fact that the application of the most favoured nation clause to dispute settlement arrangements in the context of investment treaties might result in the harmonization and enlargement of the scope of such arrangements, there are some important limits that ought to be kept in mind. As a matter of principle, the beneficiary of the clause should not be able to override public policy considerations that the contracting parties might have envisaged as fundamental conditions for their acceptance of the agreement in question, particularly if the beneficiary is a private investor, as will often be the case. The scope of the clause might thus be narrower than it appears at first sight.”<sup>62</sup>*

Since *Maffezini* there have been three more major cases dealing with the applicability of the MFN standard to dispute settlement before ICSID (*Salini*, *Siemens*, and *Plama*).<sup>63</sup> While *Maffezini* and *Siemens* are in favour of it, *Salini* and *Plama* say, at least in principle, the opposite, focusing on the intention of the parties as the decisive factor. In this view, incorporating dispute settlement provisions from other treaties via the MFN clause is only possible if the parties to the BIT have a clear and unambiguous intention to do so.

Therefore, if the Contracting Parties do not wish to extend MFN treatment to dispute settlement matters, it might be better for the BIT to explicitly say so. BITs concluded since 1995 address this issue in different ways. While a first category of BITs extends MFN treatment to dispute settlement matters, a second group expressly avoids this outcome. Most BITs, however, do not take up this matter directly.

Among the first group of BITs explicitly providing for the application of MFN treatment in dispute settlement is the agreement between Austria and Saudi Arabia (2001):

*“Article 3*

[...]

3. *Each Contracting Party shall accord the investors of the other Contracting Party in connection with the management, operations, maintenance, use, enjoyment or disposal of investments or **with the means to assure their rights to such investments** like transfers and indemnification or with any other activity associated with this in its territory, treatment not less favourable than the treatment it accords to its investors or to the investors of a third State, whichever is more favourable.”* (emphasis added)

This approach grants covered investors MFN treatment regarding any “means to assure their rights” to the investments. Dispute settlement is the means par excellence to achieve this purpose.

Other BITs use a different technique by making explicit reference to the provisions to which MFN treatment applies. The BIT between Armenia and Egypt (1995) illustrates this trend:

*”Article 3*

*National Treatment and Most-Favored-Nation Provisions*

- (1) Neither Contracting Party shall in its territory subject investments or returns of nationals or companies of the other Contracting Party to treatment less favourable than that which it accords to investments or returns of its own nationals or companies or to investments or returns of nationals or companies of any third State.*
- (2) Neither Contracting Party shall in its territory subject nationals or companies of the other Contracting Party, as regard their management, maintenance, use, enjoyment or disposal of their investments, to treatment less favorable than that which it accords to its own nationals or companies or to nationals or companies of any third State.*

(3) *In the avoidance of doubt it is confirmed that the treatment provided for the paragraphs (1) and (2) above shall apply to the provisions of Articles 1 to 11 of this Agreement.*"

Investor–State dispute settlement is addressed in article 8 of the BIT between Armenia and Egypt (1995). Consequently, the MFN standard would apply for purposes of investor–State dispute settlement.

A second category of BITs limits MFN treatment to the “*establishment, management, conduct, operation and sale or other disposition*” of an investment in the territory of the host contracting party. In this case, it seems that the MFN clause protects only substantive rights relating to the treatment of investments. The BITs between Canada and Thailand (1997), between Brunei Darussalam and the Republic of Korea (2000), and between Jordan and the United States (1997) are examples of this approach (table 15).

**Table 15. Examples of MFN provisions limiting their scope to substantive rights**

BIT between Canada and Thailand (1997)	BIT between Brunei Darussalam and the Republic of Korea (2000)	BIT between Jordan and the United States (1997)
<p style="text-align: center;">“Article III Most-Favoured-Nation (MFN) Treatment after Establishment and Exceptions to MFN</p> <p>(1) <b>Investments</b> of investors of one Contracting Party in the territory of the other Contracting Party, or returns therefrom, shall receive treatment from the latter Contracting Party which, in like circumstances, is no less favourable than that accorded in respect of the investments or returns of investors of any third State. (2) Each Contracting Party shall, in its territory, accord to <b>investors</b> of the other Contracting Party, <b>as regards their management, use, enjoyment or disposal of their investments or returns</b>, treatment no less favourable than that which, in like circumstances, it grants to investors of any third State.” (emphasis added)</p>	<p style="text-align: center;">“Article 3 Treatment of Investments</p> <p>1. Each Contracting Party shall in its territory <b>accord to investments</b> and returns of investors of the other Contracting Party, treatment no less favourable than that which it accords to investments and returns of its own investors or to investments and returns of investors of any third State, whichever is more favourable to investors of the other Contracting Party. 2. Each Contracting Party shall in its territory accord to <b>investors</b> of the other Contracting Party <b>as regards, operation, management, maintenance, use, enjoyment or disposal of their investments</b>, treatment no less favourable than that which it accords to its own investors or to investors of any third State, whichever is more favourable to investors of the other Contracting Party.” (emphasis added)</p>	<p style="text-align: center;">“Article II Treatment and Protection of Investment</p> <p>1. With respect to the <b>establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of covered investments</b>, each Contracting Party shall accord treatment no less favorable than that it accords, in like situations, to investments in its territory of its own nationals or companies (hereinafter “national treatment”) or to investments in its territory of nationals or companies of a third country (hereinafter “most favored nation treatment”), whichever is more favorable.” (emphasis added)</p>

A third category of BITs simply states that MFN treatment applies to covered investments. An example is the BIT between Algeria and Indonesia (2000):

*“Article III  
Most-Favoured-Nation Provisions*

[...]

2. *More particularly, each Contracting Party shall accord to such investments treatment which in any case shall not be less favourable than that accorded to investments of investors of any other third State [...].”*

Unlike in the *Maffezini* case, where the applicable BIT specified that the MFN standard applied with respect to *all matters* covered by the agreement, these BITs do not contain such a qualification. Thus, it is not clear that the MFN clause could be interpreted in a manner that led to the same outcome as in *Maffezini*. Furthermore, as recognized by the arbitral tribunal in that particular dispute, it is equally important whether

the dispute settlement provisions agreed in the original BIT reflect public policy considerations that the contracting parties might have envisaged as fundamental conditions for their acceptance of the agreement in question.

Notwithstanding the limitations previously referred to, there are strong arguments both for and against applying the MFN clause to dispute settlement. In the end, this issue may need further clarification by international investment jurisprudence.

## (ii) Exceptions to the MFN standard

In addition to exceptions of general applications, most recent BITs contain specific exceptions applicable to the MFN standard. The approaches taken depend on whether the particular BIT applies only to established investments or also to investors in the pre-establishment phase.<sup>64</sup>

Those BITs providing protection only in the post-establishment phase normally include two MFN exceptions. One permits the contracting parties to deny investors of the other contracting party more favourable treatment resulting from membership of regional economic integration organizations. The rationale for this REIO exception stems from the nature of regional economic integration, which purports to grant privileges to the member countries in exchange for a reciprocal preferential treatment. The REIO exception prevents these privileges from being extended to those contracting parties of BITs with which such a reciprocal integration relationship does not exist (UNCTAD 2005d).

The second exception excludes any advantage granted to a third country under a double-taxation treaty (DTT) from the application of the MFN clause. The reason for this exception is once again the inherent reciprocal nature of these kinds of agreements and the complexity involved in dealing with tax matters.

There are variations in the wording and scope of these exceptions. For instance, the REIO exception may apply only with respect to agreements of regional economic integration, such as free trade areas, customs unions, common markets or similar arrangements. The BIT between Belgium–Luxembourg and Pakistan (1998) is an illustration:

*“Article 4  
Treatment*

[...]

3. *However, this treatment shall not extend to the privileges that one Contracting Party may grant to investors of a third country by virtue of its membership or association with any existing or future free trade area, customs union, common market or similar international agreement to which any of the Contracting Parties is or may become a Party.”*

Other BITs exempt from the MFN obligation any preference derived from a wider group of agreements, and include also other forms of regional cooperation. The BIT between Ethiopia and Malaysia (1998) demonstrates this method:

*“Article 3  
Most-Favoured-Nation Treatment*

[...]

2. *The provisions of this Agreement relative to the granting of treatment not less favourable than that accorded to investors from any third State shall not be construed so as to oblige to extend to the investors of the other the benefit of any treatment, preference or privilege resulting from:*
- (a) *any existing or future customs area or free trade area or a common market or a monetary union or similar international agreement or other forms of regional cooperation to which either of the Contracting Parties is or may become a party; or to the adoption of an agreement designed to lead to the formation or extension of such union or area within a reasonable length of time; [...].” (emphasis added)*



Also with regard to taxation matters, BITs reviewed differ concerning the scope of the MFN exception. While some agreements, such as the BIT between Bahrain and China (1999), exclude only those advantages derived from existing or future double taxation agreements, other BITs, such as the agreement between Honduras and the Republic of Korea (2000), exempt any advantage resulting from any international agreement dealing with taxation in general. Other BITs go even further and exclude from the scope of the MFN clause not only any international agreement but also any other matter pertaining to taxation. The BIT between Austria and India (1999) shows the latter trend (table 16).

BITs providing for MFN treatment both in the pre- and post-establishment phases follow a different approach regarding the exceptions to this obligation. They include general exceptions applicable with respect to any of the obligations contained in the agreement. However, as far as MFN treatment is concerned, these BITs do usually not include specific exceptions in the body of the agreement.<sup>65</sup> Rather, contracting parties negotiate the reservations that will apply to this obligation as these instruments are often based on a negative list approach. Contracting parties may not only exempt all existing non-conforming measures from the application of the MFN treatment, but also exclude whole sectors or economic activities through the annex on “future measures” usually included in this kind of BIT.<sup>66</sup>

**Table 16. Examples of MFN provisions excluding taxation**

BIT between Bahrain and China (1999)	BIT between Honduras and the Republic of Korea (2000)	BIT between Austria and India (1999)
<p>“Article 3</p> <p>[...]</p> <p>3. The treatment and protection as mentioned in Paragraphs 1 and 2 of this Article shall not include any preferential treatment accorded by the other Contracting Party to investments of investors of a third Party based on customs unions, free trade zones, economic unions, or <b>agreements relating to avoidance of double taxation</b> or for facilitating frontier trade.” (emphasis added)</p>	<p>“Article 3</p> <p>Treatment of investments</p> <p>[...]</p> <p>3. The provisions of paragraphs 1 and 2 of this Article shall not be construed so as to oblige one Contracting Party to extend to the investors of the other Contracting Party the benefit of any treatment, preference or privilege resulting from <b>any international agreement or arrangement relating wholly or mainly to taxation</b>, customs or economic union, a free trade area or regional economic organization.” (emphasis added)</p>	<p>“Article 3</p> <p>Treatment of investments</p> <p>[...]</p> <p>(3)The provisions of paragraph (1) shall not be construed as to oblige one Contracting Party to extend to the investors of the other Contracting Party and their investments the present or future benefit of any treatment, preference or privilege resulting from: [...]</p> <p>(b) <b>any matter, including international agreements, pertaining wholly or mainly to taxation.</b>” (emphasis added)</p>

\* \* \*

To sum up, BITs concluded in the review period contain absolute and relative standards of protection. Among the first category are the principles of fair and equitable treatment, full protection and security, and the minimum standard of treatment according to international law; BITs of the last decade usually include at least one of these standards. A remarkable new approach — hitherto limited to a small number of BITs — is to clarify the meaning of the minimum standard of treatment in more detail, including its relationship to the principles of fair and equitable treatment and full protection and security.

The vast majority of BITs under review contain — in a variety of ways — the relative protection standards of national treatment and most-favoured-nation treatment. While most BITs continue to limit the application of these two principles to the post-establishment phase, the number of countries extending these treaty standards to the entry of foreign investment is increasing. An important new development is the interpretation of the scope of the MFN principle by arbitration tribunals, which has not always been consistent. While conflicting awards have so far been limited to the issue of the application of the MFN principle with regard to dispute settlement, it appears that the question at stake is of a more general nature. Up to now, only a few BITs have addressed this issue in more detail.

## F. Expropriation

Historically, one of the main drivers of BITs has been foreign investors' concern to protect their investments against the risk of unlawful expropriation.<sup>67</sup> In general, BITs allow countries to expropriate foreign investments on a non-discriminatory basis, for a public purpose and against the payment of compensation (UNCTAD, 2000a).

Expropriation has continued to rank high in BIT negotiations. As will be explained below, the most significant trend has been a shift in the legal debate. Traditionally, it focused on the conditions for lawful expropriation. The overall level of convergence on this issue among BITs of the last decade is remarkable, except on the details concerning compensation. However, the discussion now concentrates on the question of indirect expropriations.

### 1. Definition of expropriation: From nationalizations to regulatory takings

Following the traditional trend, BITs under review recognize the right of host countries to expropriate or nationalize foreign private property subject to certain conditions.<sup>68</sup> Most expropriation clauses apply to *expropriations* and *nationalizations*, and they generally avoid defining these terms as well as clarifying the distinction between the two.<sup>69</sup>

Although the specific wording may vary, most expropriation clauses have continued with the traditional approach of extending protection to those measures of the host country that may have *an effect equivalent* to expropriation or are *tantamount* to expropriation. Other agreements use the term *indirect expropriations*.<sup>70</sup>

The BIT between Chile and Tunisia (1998) is an example of an expropriation clause used in numerous investment agreements:

“Article 6  
*Expropriation and compensation*”

(1) *Neither Contracting Party shall nationalize, expropriate or **subject the investments of an investor of the other Contracting Party to any measures having an equivalent effect** (hereinafter referred to as "expropriation") unless the following conditions are complied with: [...]*” (emphasis added)

Expropriation clauses such as this one do not define the terms *expropriation* or *nationalization*. They also do not define or establish any criteria to identify *measures having an effect equivalent* to expropriation or nationalization. One of the aspects that has generated controversy is a lack of clarity regarding the degree of interference with the rights of ownership required for an act or series of acts to constitute an indirect expropriation.

Countries frequently enact regulations to pursue a wide range of public policy objectives. A broad concept of indirect expropriation could have the effect of converting a country's routine regulatory acts into a potential indirect taking, and, consequently, entailing compensation in favour of the affected foreign investor. On the other hand, recent arbitral awards have emphasized the extraordinary nature of an indirect taking, meaning that normal regulatory activity of a country does usually not amount to an expropriation.<sup>71</sup>

A number of issues contribute to the concern about a possible over-expansive interpretation of the concept of indirect expropriation.

Not all legal systems apply the same criteria to determine whether an indirect expropriation has occurred. This has generated apprehension in some countries, which see BITs as vehicles for introducing notions about expropriation that are alien to, and contradict, domestic legal traditions.

It has been argued that BIT provisions on expropriation should apply to those actions that *substantially impair the value* of an investment. The problem with this view is that a myriad of routine regulatory actions by a country may have this effect. Some countries, including parts of civil society, have strongly opposed international investment disciplines being interpreted in this manner. They argue that, otherwise, BITs could be perceived as instruments tipping the balance in favour of foreign investors at the expense of the freedom that countries should have to fully exert their regulatory powers to pursue the public good.<sup>72</sup>

It has been recognized that an investment can be expropriated not only in its entirety, but also in respect of its individual components (e.g. management rights, export rights, licences) (Sornarajah, 2004, pp. 239–246). While this *unpacking* of property rights improves the legal protection of foreign investors, it may become more difficult to determine when an expropriation has taken place and what amount of compensation is due.

Another reason for concern has been the language of expropriation clauses. Numerous BITs have expropriation provisions broad enough to suggest that every measure substantially impairing the value of an investment could be challenged as an indirect expropriation. This is the case of some agreements, which not only oblige host countries to refrain from directly or indirectly expropriating or nationalizing an investment, but also include a clause stating that the host country should abstain from adopting any *measure or measures having equivalent effect*. A case in point is the BIT between China and Jordan (2001):

“Article 5  
Expropriation

1. *A Contracting Party shall not **expropriate or nationalize directly or indirectly** an investment in its territory of an investor of the other Contracting Party **or take any measure or measures having equivalent effect** (hereinafter referred to as "expropriation") [...]* (emphasis added)

Since this provision explicitly prohibits the host country from taking *any measure or measures having an equivalent effect*, the question arises as to whether, in addition to direct and indirect expropriation, the clause recognizes a third category of measures as covered by the expropriation provision. Although this issue has already been addressed in other contexts, the potential effects of this specific treaty language are yet to be explored. Similar doubts exist with regard to the term “tantamount to expropriation”.<sup>73</sup>

A survey of recent BITs shows that not all agreements address the issue of indirect expropriation in the same manner. In addition to the group of treaties that follow the "double reference" approach explained above, the BITs can be divided in several categories.

A first group comprises those expropriation provisions that do not include a specific reference to indirect expropriations.<sup>74</sup> There is the question of whether under this kind of provision an investor of a contracting party could invoke treaty protection in the case of an indirect expropriation.<sup>75</sup>

A second category comprises the BITs that protect investments from direct and indirect expropriation. The BIT between Kuwait and Lithuania (2001) is an example:

“Article 6  
Expropriation

- (1) (a) *Investments of either Contracting State or any of its investors **shall not be nationalized, expropriated or subjected to direct or indirect measures having effect equivalent to nationalization or expropriation** (hereinafter collectively referred to as "expropriation") by the other Contracting State [...]* (emphasis added)

While this provision makes reference to direct and indirect takings, it does not provide any guidance regarding the criteria to be used in order to determine whether an indirect expropriation has in fact occurred.

A third category of BITs comprises those agreements that additionally include an implicit guidance regarding the level of interference that would be required for a measure to constitute an indirect expropriation. These BITs suggest that the expropriation clause is not intended to deem any impairment of the value of the investment to be an indirect expropriation. Rather, the language indicates that an expropriation — either direct or indirect — may occur only where the measure has the effect of a *taking* of private property by the State. The BIT between France and Uganda (2002) demonstrates that concept:

“Article 5  
*Dispossession and indemnification*”

[...]

2. *Neither Contracting Party shall take any measures of expropriation or nationalization **or any other measures having the effect of dispossession**, direct or indirect, of nationals or companies of the other Contracting Party of their investments on its territory and in its maritime area, except in the public interest [...]* (emphasis added)

Other BITs, such as those of Hong Kong (China), use the term *deprivation* when making reference to indirect expropriations. An illustration is the BIT with the United Kingdom (1998):

“Article 5  
*Expropriation*”

- (1) *Investors of either Contracting Party shall not be deprived of their investments nor be subjected to measures having effect equivalent to such **deprivation** in the area of the other Contracting Party except [...]* (emphasis added)

Some BITs take into consideration issues that have arisen in the context of recent investment disputes. They include explicit criteria in order to determine on a case-by-case basis whether a particular measure amounts to an indirect expropriation. The 2004 Canadian model BIT and recent BITs of the United States fall within that category. Annex B of the BIT between the United States and Uruguay (2005) exemplifies this approach:

“Annex B  
*Expropriation*”

*The Parties confirm their shared understanding that:*

1. *Article 6(1) is intended to reflect customary international law concerning the obligation of States with respect to expropriation.*
2. *An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment.*
3. *Article 6(1) addresses two situations. The first is known as direct expropriation, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure.*
4. *The second situation addressed by Article 6(1) is known as indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.*
  - (a) *The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:*
    - (i) *the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;*
    - (ii) *the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and*
    - (iii) *the character of the government action.”*

The language of this annex is self-explanatory. It shows the intention of the contracting parties to increase the clarity of BIT provisions to prevent an arbitral tribunal from having broad discretion in interpreting the expropriation clause in the context of a potential dispute.

## 2. Conditions for lawful expropriation

As mentioned at the beginning of this section, the international debate on the law on expropriation originally focused on the prerequisites for lawful expropriation (Sornarajah, 2004). Some countries — mostly capital-exporting economies — argued that under customary international law, countries were allowed to expropriate foreign investors provided that the expropriation measure met four conditions: it had to be taken for a public purpose, on a non-discriminatory basis, under due process of law and based upon the payment of prompt, adequate and effective compensation. As a number of developing countries denied that such conditions were part of customary international law, capital-exporting economies turned to conventional international instruments — mostly BITs — to specifically provide for investment protection against unlawful expropriations.

A survey of the BITs concluded since 1995 reveals a remarkable degree of convergence with respect to the conditions required to make expropriations lawful. Most agreements include the four substantive requirements mentioned above (table 17).

**Table 17. Examples of requirements for lawful expropriations**

BIT between Angola and the United Kingdom (2000)	BIT between Belarus and Croatia (2001)
<p style="text-align: center;">“Article 5 Expropriation</p> <p>(1) Investments of nationals or companies of either Contracting Party shall not be nationalised, expropriated or subjected to measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as "expropriation") in the territory of the other Contracting Party except for a <b>public purpose related to the internal needs of that Party on a non-discriminatory basis and against prompt, adequate and effective compensation.</b> [...] The national or company affected shall have a <b>right, under the law of the Contracting Party making the expropriation, to prompt review, by a judicial or other independent authority of that Party, of his or its case and of the valuation of his or its investment in accordance with the principles set out in this paragraph.</b> [...]" (emphasis added)</p>	<p style="text-align: center;">“Article 5 Expropriation</p> <p>1. A Contracting Party shall not, in its territory, expropriate or nationalise directly or indirectly an investment of an investor of another Contracting Party or take any measure or measures having equivalent effect (hereinafter referred to as "expropriation" except: <b>a) for a purpose which is in the public interest, b) on a non-discriminatory basis, c) in accordance with due process of law, and d) accompanied by payment of prompt, adequate and effective compensation.</b> [...]" (emphasis added)</p>

However, some important differences remain among BITs. They mainly relate to the content given to the concept of due process, and the degree of specificity with which the issue of compensation is dealt with.

### a. The concept of due process

Most BITs under review include a reference to some sort of due process concept that has to be respected by a contracting party when taking an expropriation measure. One group of treaties refers to the principle of legality, requiring that the expropriation procedure comply with domestic legislation. An example of this model is article 4.1 of the BIT between the Russian Federation and Thailand (2002), which provides that the expropriation measures, to be lawful, must be “[...] *taken for the public interests in accordance with the procedure established by the laws of the Contracting Party* [...]”.

Other agreements focus on the due process concept understood as the right of the affected investor to an audience and an impartial hearing to review the case. An illustration of this approach is the BIT between Canada and Trinidad and Tobago (1995):

*“Article VIII  
Expropriation*

[...]

2. *The investor affected shall have a right, under the law of the Party making the expropriation, to prompt review, by a judicial or other independent authority of that Party, of its case and of the valuation of its investment in accordance with the principles set out in this Article.”* (emphasis added)

Regardless of whether an expropriation has to comply with the legal procedures established in the domestic legislation or whether an investor has the explicit right to an independent review of the expropriation, both concepts have something in common. Neither of them gives the host Government total discretion in determining whether an expropriation may be undertaken or in choosing the applicable procedures.

### b. Compensation

The determination of what kind of compensation has to be paid in the case of an expropriation once ranked among the most debated issues between developed and developing countries (Somarajah, 2004). Capital-exporting countries advocated that compensation should be *prompt, adequate and effective*, while some developing countries promoted other standards existing in their domestic legislations.<sup>76</sup>

Today, however, there is an increasing level of convergence among IIAs regarding the standard of compensation. One of the most salient trends among recent BITs is that most agreements include language that has the effect of applying the standard of prompt, adequate and effective compensation. Furthermore, most provide that the compensation has to reflect the actual price of the investment (table 18). For this purpose, reference is made to the market value, the fair market value or the genuine value of the taken assets.

**Table 18. Examples of clauses on compensation within expropriation provisions**

BIT between Brunei Darussalam and the Republic of Korea (2000)	BIT between Egypt and Thailand (2000)
<p style="text-align: center;">“Article 5 Expropriation</p> <p>1. Investments of investors of one Contracting Party shall not be nationalised, expropriated or otherwise subjected to any other measures having an effect equivalent to nationalisation or expropriation (hereinafter referred to as "expropriation") in the territory of the other Contracting Party except for public purpose and against <b>prompt, adequate and effective compensation</b>. The expropriation shall be carried out on a non-discriminatory basis in accordance with legal procedures.</p> <p>2. <b>Such compensation shall amount to the fair market value of the expropriated investments immediately before expropriation was taken or before impending expropriation became public knowledge, whichever is the earlier, shall include interest at the applicable commercial rate or LIBOR rate, whichever is higher, from the date of expropriation until the date of payment and shall be made without undue delay, be effectively realisable and be freely convertible and transferable.</b> ” (emphasis added)</p>	<p style="text-align: center;">“Article 5 Nationalization or Expropriation</p> <p>1. [...]</p> <p>(b) Investments of investors of either Contracting Party or any of its natural or juridical persons shall not be directly or indirectly nationalized, expropriated or subjected to measures having effect equivalent to nationalization or expropriation, in the territory of either Contracting Party except for a public purpose, and against <b>payment of compensation. Such compensation shall be adequate, effectively realizable, made without delay and freely transferable in freely convertible currencies. Such measures are taken on a non-discriminatory basis and subject to review by due process of law.</b></p> <p>(c) <b>Such compensation shall amount to the market value of the investment expropriated on the date the measure was taken.</b> ” (emphasis added)</p>

Thus, rulemaking regarding expropriation has evolved towards a more sophisticated stage. The differences among BITs now focus on the level of specificity with which concrete issues related to compensation are addressed.

Compensation clauses may specify the amount of compensation, the currency in which it is to be paid and the period for payment. However, some BITs contain compensation provisions drafted with greater detail, and address several additional issues. There is the question of whether compensation should include interest and what should be the criteria to determine it. Second, should compensation be paid in a freely convertible or freely usable currency? And who should bear the risk of devaluation?

### c. Applicable interest

Expropriations usually entail administrative procedures that take some time to be completed. Although most BITs provide that payment of compensation shall be “prompt” or “without delay”, there may be a time lag between the date the investor is dispossessed from its investment and the date of payment. This raises a number of questions. Should compensation be based only on the market value of the taken investment or also include interest? If interest has to be paid, what should be the applicable rate? Finally, what should be the period during which interest has to be paid?

Regarding the first question, one can distinguish several approaches. A number of BITs do not address this issue at all. Among this group are, inter alia, the treaties between Japan and Pakistan (1998), Argentina and Thailand (2000), and Cambodia and Indonesia (1999). Conversely, other BITs do provide for the possibility of including interest within the compensation, but only in those situations when payment is delayed. The BIT between the Russian Federation and Thailand (2002), and the agreement between Jordan and Morocco (1998), are examples of this concept. The latter treaty states as follows:

*“Article 4  
Expropriation*

[...]

3. *These measures shall be accompanied with allocations for prompt and effective payment of compensation provided that the compensation shall be equal to the value of the investment prevailing in the market at the time of expropriation decision announcement and the compensation shall be transferable in freely convertible currency with the Contracting Party, and in the event that payment of compensation is delayed the investor shall receive interest at the prevailing market rate in business transactions at the date of compensation payment.”*  
(emphasis added)

Another category of agreements states that interest shall always be included in the compensation if there is a time lag between the expropriation measures and the payment. Article 7.3 of the BIT between Australia and India (1999) is an example of this approach. It provides that in case of expropriation, the compensation “[...] shall be paid without undue delay, shall include interest at a normal market rate from the date the measures were taken to the date of payment and shall be freely transferable between the territories of the Contracting Parties. The compensation shall be payable either in the currency in which the investment was originally made or, if requested by the investor, in any other freely convertible currency.”

Among those BITs that include the payment of interest, there is a group that states only that such interest shall be *appropriate*, but does not include any objective criteria to calculate it. For example, the BITs that Japan has concluded with Bangladesh (1998) and the Republic of Korea (2002) fall into this category. Other agreements, such as the BIT between Australia and Lithuania (1998), explicitly state that the applicable interest shall be calculated on the basis of the market rate.

According to a third group, the interest shall be calculated using the applicable domestic rates, or by making reference to domestic laws. An example of this approach is the BIT between the Russian Federation and Thailand (2002):

“Article 4

[...]

2. *In case of delay the interest shall be paid from the date the payment was due until the date of actual payment at the following rate:*
  - a) *in Thailand*
    - (i) *in case of immovable property, from the date compensation is determined by the committee established under Article 23 of the Immovable Property Expropriation Act at the highest rate of interest for the **fixed deposits of the Government Savings Bank**;*
    - (ii) *in the case of movable property, **as determined by the Civil and Commercial Code**;*
  - b) *in Russia*
    - (i) *the **Russian interbank rate** for three month deposit in foreign currency, if the investments were made in foreign currency;*
    - (ii) *the rate of interests for Russian state short-term notes, issued in Russian currency, if the investments were made in national currency.”* (emphasis added)

Some BITs state that interest shall be paid between the date of expropriation and the date of payment. Examples are the agreements between Cyprus and the Russian Federation (1997), Australia and Chile (1996), and Malaysia and Saudi Arabia (2000). However, it may not be easy to determine the exact date of expropriation. Is it the date of enactment of the expropriation decree? Or the date on which the decree is actually implemented? Or rather the date on which the investor is dispossessed of the investment?

To avoid these uncertainties, other BITs seek to clarify the specific moment from which to calculate the applicable interest. This is the case of the BITs of Costa Rica with the Republic of Korea (2000) and Chile (1996). The latter treaty stipulates the following:

“Article VI

[...]

2. *Compensation shall be based on the fair market value of the expropriated investments immediately before expropriation was taken or before impending expropriation became public knowledge, whichever is the earlier. It shall include interest based on the applicable commercial rate **from the date of dispossession of the expropriated property until the date of payment** and shall be made without undue delay, be effectively realizable and be freely transferable [...]*” (emphasis added)

The reference to dispossession is intended to focus on the date when the investor felt the impact of the Government's action as opposed to the date on which the Government's action was taken. In this sense, one could say that *dispossession* is a more specific term than *expropriation*, although even the date of dispossession might be difficult to ascertain in cases of indirect expropriation. On the other hand, those BITs that accord interest only in case of delay provide that it is due from the moment the country experiences delay until the date of payment.<sup>77</sup>

#### d. Currency in which compensation has to be paid

An issue that frequently arises is whether compensation has to be paid in a *freely usable* currency as opposed to any *freely convertible* currency.<sup>78</sup> BITs of the last 10 years have followed different concepts, some of which give Governments more leeway than others.

A first group of BITs does not specify which currency to use for purposes of payment of compensation. In this case, the contracting party is free to pay in whichever currency it considers appropriate, provided that this is in compliance with the terms of the agreement. Among the BITs falling into this category are those between Pakistan and the Syrian Republic (1996), South Africa and Turkey (2000), Germany and Sri Lanka (2000), and Mauritius and South Africa (1998).

Numerous BITs state that compensation has to be paid in any "*freely convertible currency*". The BIT between Ethiopia and Sudan (2000) illustrates this idea:



*“Article 4  
Expropriation and Nationalization*

[...]

- (c) *The measures are taken against prompt, adequate and effective compensation. Such compensation shall amount to the market value of the investments affected immediately before the measures of expropriation or nationalization are taken or became public knowledge, and it shall be freely transferable in a **freely convertible currency** from the Contracting Party. Any unreasonable delay in payment of compensation shall carry on interest at prevailing commercial rate as agreed upon by both parties unless such rate is prescribed by law.”*  
(emphasis added)

Other agreements, such as the BIT between Australia and Lithuania (1998), provide that compensation may be paid in the currency in which the investment was originally made, or, at the request of the investor, in any other freely convertible currency.

Unlike the BITs previously referred to, a number of agreements stipulate that compensation shall be paid in a freely usable currency. Article 5 of the BIT between Belgium–Luxembourg and Thailand (2002) is an example of this trend and provides that in case of expropriation, compensation “[...] shall be in freely usable currencies in keeping with the standards and accepted principles of international law [...]”. This particular agreement provides that the term “freely usable currencies” “shall mean currencies that the International Monetary Fund determines, from time to time, as freely usable currencies in accordance with the Articles of Agreement of the International Monetary Fund and Amendments thereafter”.

**e. Risk of devaluation**

As explained in subsection F.2.b above, if BITs provide that compensation shall be paid in a *freely usable* currency, a foreign investor would be protected against the risk of a devaluation of the host country's currency during the expropriation process. Theoretically, the situation should be the same in those cases where the host country is obliged to pay in any freely convertible currency. In fact, until the final payment is made, the host country is obliged to provide full compensation. In practice, however, most countries have to follow a series of procedures in order to process payments once the final amount to be paid has been fixed. This may lead to situations in which there is a delay between the date on which the amount to be paid is fixed — in convertible currency — and the actual payment. This raises the question as to who should bear the risk of a devaluation of the convertible currency. Among the few recent BITs that address this specific issue, two concepts can be distinguished.

Some BITs provide the investor with a general protection clause against all risks associated with the real value of the compensation during the expropriation process. Article 5.3 of the BIT between Bangladesh and Japan (1998) illustrates this method by stating that in case of expropriation, the compensation “[...] shall be paid in a manner which would place investors in a position no less favorable than the position in which such investors would have been if the compensation had been paid immediately on the date of expropriation, nationalization or any other measure the effect of which would be tantamount to expropriation or nationalization”.

Other recent BITs address the risk of currency devaluation in more specific terms. For instance, the BIT between the United States and Uruguay (2005) states the following:

*“Article 6  
Expropriation and Compensation*

[...]

3. *If the fair market value is denominated in a freely usable currency, the compensation referred to in paragraph 1(c) shall be no less than the fair market value on the date of expropriation, plus interest at a commercially reasonable rate for that currency, accrued from the date of expropriation until the date of payment.*

4. *If the fair market value is denominated in a currency that is not freely usable, the compensation referred to in paragraph 1(c) – converted into the currency of payment at the market rate of exchange prevailing on the date of payment – shall be no less than:*
- (a) the fair market value on the date of expropriation, converted into a freely usable currency at the market rate of exchange prevailing on that date, plus*
  - (b) interest, at a commercially reasonable rate for that freely usable currency, accrued from the date of expropriation until the date of payment.”*

This provision states that if the payment of compensation is not made in a freely usable currency, it has to be equivalent to the amount that would have been paid in a freely usable currency at the date the payment becomes effective.

\* \* \*

Several trends concerning expropriation clauses in BITs become evident from the above.

Most agreements include the same four requirements for a lawful expropriation, namely public purpose, non-discrimination, due process and payment of compensation. Furthermore, most BITs have similar provisions regarding the standard of compensation. Notwithstanding some variations in language, the overwhelming majority of BITs provide for prompt, adequate and effective compensation, based on the market or genuine value of the investment. However, BITs differ on the degree of specificity and sophistication concerning the calculation and payment of compensation. The normative convergence among the BITs regarding the conditions for expropriation reflects the important domestic reforms that most developing countries have undertaken during the last 20 years to improve their domestic investment climate.

The above trend contrasts with the variety of means in BITs with respect to the newly emerging issue of indirect expropriations or regulatory takings. Recent investment disputes on this matter have caused some countries, in particular the United States and Canada, to redraft their model BITs. However, at least for the time being, most contracting parties to BITs continue to agree on broad and general clauses to delimit the scope of the expropriation provision — the kind of language that has led to controversy in the context of many investor–State disputes. On the other hand, countries may need more time to assess the impact of these awards on their BIT practice before arriving at any conclusions concerning the need to modify the expropriation clause.

### **G. War and civil disturbance**

Traditionally, many BITs have included clauses ensuring non-discriminatory treatment of foreign investors in situations where their property is damaged as a result of war or civil strife. BITs under review have continued with this trend, although with some variations.

The rationale for including a clause on war and civil disturbance in BITs is that war and civil strife are exceptional situations, which are often excluded from the coverage of insurance contracts that investors may have concluded. Furthermore, customary international law recognizes the exceptional character of a state of national emergency, and distinguishes between destruction of property due to military action and expropriation in ordinary circumstances. As explained in the previous section, while in the latter case customary international law obliges the host country to pay compensation, the general consensus in situations where property is destroyed because of military necessity is that no such obligation exists (UNCTAD 1998).<sup>79</sup>

However, contracting parties to BITs have considered it important to provide investors with some protection against losses incurred in these unusual situations. What are the scope and the content of such clauses in recent BITs?

### 1. Scope of the compensation for losses

Most BITs include a clause on protection for losses due to situations of war, insurrection, riot, rebellion or other civil disturbance. This trend has continued in the review period, and is illustrated by the BIT between Bangladesh and Japan (1998):

*“Article 6*

*Investors of either Contracting Party who suffer within the territory of the other Contracting Party damage in relation to their investments, returns or business activities in connection with the investment, **owing to the outbreak of hostilities or a state of national emergency such as revolution, revolt, insurrection or riot**, shall be accorded treatment no less favorable than that accorded to investors of such Contracting Party or to investors of any third country, as regards to any measure to be taken by the other Contracting Party including restitution, compensation, or other valuable consideration. In case payments are made under the present Article, the payments shall be effectively realizable, freely convertible, and freely transferable.”* (emphasis added)

The situations envisaged above are all related to cases of violence attributable to mankind. There is, however, a small group of BITs that extend the coverage to damage caused by natural disasters.<sup>80</sup> The BIT between Mexico and the Netherlands (1998) is an example:

*“Article 6*

*Compensation for Losses*

*Nationals of the one Contracting Party who suffer losses in respect of their investments in the territory of the other Contracting Party **owing to acts of God, war or other armed conflict, revolution, state of national emergency, revolt, insurrection or riot** shall be accorded by the latter Contracting Party treatment, as regards restitution, indemnification, compensation or other settlement, no less favorable than that which that Contracting Party accords to its own nationals or to nationals of any third State, whichever is more favorable to the nationals concerned.”* (emphasis added)

By inserting the reference to acts of God this provision refers to fortuitous events of nature without involvement of the State.

Another group of BITs contains clauses whose scope is not clear. Numerous BITs fall into this category, and provide that protection shall be granted in situations of *national emergency*. The BIT between Australia and Egypt (2001) demonstrates this approach:

*“Article 8*

*Compensation for losses*

*When a Party adopts any measures relating to losses in respect of investments in its territory by citizens or companies of any other country **owing to war or other armed conflict, revolution, a state of national emergency, civil disturbance or other similar events**, the treatment accorded to investors of the other Party as regards restitution, indemnification, compensation or other settlement shall be no less favourable than that which the first Party accords to citizens or companies of any third country.”* (emphasis added)

As a natural disaster can be the cause of a state of national emergency, one could conclude that the protection of the BIT would apply in these situations. On the other hand, most BITs refer to a state of national emergency within the context of a conflict.

## 2. Protection provided

The standard of protection granted by BITs in the case of damage caused by war or civil disturbance also varies.

A very scant number of agreements does not address the issue at all.<sup>81</sup> However, such situations might be covered by the separate obligation to provide the investor with full protection and security.<sup>82</sup>

A second group of BITs comprises those agreements that grant MFN treatment with respect to any compensation given by the host country for losses caused by war, insurrection or similar events. The BIT between Ethiopia and Malaysia (1998) illustrates this concept.

*“Article 4  
Compensation for Losses*

*Investors of one Contracting Party whose investments in the territory of the other Contracting Party suffer losses owing to war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot in the territory of the latter Contracting Party shall be accorded by the latter Contracting Party **treatment, as regards restitution, indemnification, compensation or other settlement, no less favourable than that which the latter Contracting Party accords to investors of any other third State.**”* (emphasis added)

According to this method, the host country does not have to pay compensation to foreign investors, even if the country does provide compensation to its own nationals. However, if a contracting party opts to compensate foreign investors of any third country, it must compensate investors covered by the treaty in a no less favourable manner.

Other BITs provide covered investors with national treatment in addition to MFN treatment. The BIT between Turkey and Yemen (2000) is an example of this widely used method:

*“Article III  
Expropriation and Compensation*

[...]

*3. Investors of either Party whose investments suffer losses in the territory of the other Party owing to war, insurrection, civil disturbance or other similar events shall be accorded by such other Party **treatment no less favourable than that accorded to its own investors** or to investors of any third country, whichever is the most favourable treatment, as regards any measures it adopts in relation to such losses.”* (emphasis added)

Within this group of BITs, a variation exists in conditioning the provision of national treatment to the domestic legislation. The BIT between Argentina and New Zealand (1999) is a case in point:

*“Article 7  
Compensation for other Losses*

*The investors of one Contracting Party whose investments in the territory of the other Contracting Party have suffered losses due to a war or any other armed conflict, revolution, state of emergency or rebellion, which took place in the territory of the other Contracting Party shall be accorded by the latter Contracting Party treatment, as regards restitution, indemnification, compensation or other settlement, no less favourable than that which the latter Contracting Party accords investors of any state **or, subject to its laws and regulations, to its own investors.**”* (emphasis added)

Another variant within the group of BITs granting both MFN treatment and national treatment is to distinguish whether the damage was caused by a conflict as opposed to fortuitous situations such as natural disasters. This is the case of article 8 of the BIT between Cuba and Mexico (2001), which provides that the

contracting parties shall grant MFN treatment and national treatment with respect to any compensation that the host country provides to its own investors in the case of losses due to armed conflict, civil strife, state of emergency and other similar circumstances. Conversely, the contracting parties are obliged to provide MFN treatment only if the losses are due to fortuitous events.

The different means explained above all entail relative standards of protection — that is, the host country is free to decide whether it wants to compensate or not, but has to do so on a non-discriminatory basis. As said before, a BIT may, however, also include the absolute treaty standard of full protection and security to the effect that the foreign investor might be entitled to claim compensation.

There is a fourth category of compensation-for-losses clauses, which have attempted to go one step further in providing protection to the investor. These BITs identify specific situations in which, regardless of any applicable relative standard of protection, the host country has an absolute obligation to compensate the foreign investor. They make a distinction between damages caused by war and civil disturbance without direct action by the host country and damages caused by it. In the first situation, these BITs do not impose an absolute obligation to compensate; rather, national treatment and MFN treatment would apply. By contrast, in cases where the host Government has requisitioned the property or has caused unnecessary damage to the investment, there would be an absolute obligation to compensate. The BIT between Hong Kong (China) and the United Kingdom (1998) illustrates this idea:

“Article 4  
*Compensation for Losses*

[...]

(2) *Without prejudice to paragraph (1) of this Article, investors of one Contracting Party who in any of the situations referred to in that paragraph suffer losses in the area of the other Contracting Party resulting from:*

*(a) requisitioning of their property by its forces or authorities; or*

*(b) destruction of their property by its forces or authorities, which was not caused in combat action or was not required by the necessity of the situation;*

***shall be accorded restitution or reasonable compensation. Resulting payments shall be freely convertible.*** (emphasis added)

Differences also exist among reviewed BITs with respect to the amount of compensation. Some BITs do not explicitly include any parameter regarding the applicable compensation.<sup>83</sup> Other agreements, such as the BIT between Hong Kong (China) and the United Kingdom (1998) cited above, only make reference to “*restitution or reasonable*” compensation. Another means, as illustrated by the BIT between Honduras and the Republic of Korea (2000), is to provide for adequate compensation in accordance with national treatment and MFN treatment. Other BITs oblige the contracting parties to provide “*prompt, adequate and effective*” compensation, as is the case of the BIT between Belgium–Luxembourg and Pakistan (1998). Another way is to delegate the determination of compensation, if applicable, to domestic legislation. The BIT between Mauritius and Singapore (2000) illustrates this technique (table 19).

\* \* \*

In conclusion, the majority of BITs of the last decade include a provision on protection for losses due to war, civil disturbance and similar events. While most of them cover violent events attributable to human beings, a small group of BITs extend protection to natural disasters. The standards of protection are national treatment and most-favoured-nation treatment; different approaches exist as to whether protection is limited to one of these standards or whether they are cumulatively provided. A number of BITs identify specific situations where the host country has an absolute obligation to compensate.

Table 19. Examples of provisions on compensation for losses

BIT between Belgium-Luxembourg and Pakistan (1998)	BIT between Honduras and the Republic of Korea (2000)	BIT between Mauritius and Singapore (2000)
<p>“Article 6 Compensation for losses</p> <p>[...] <b>Any payment made under this Article shall be prompt, adequate, effective and freely transferable.</b>” (emphasis added)</p>	<p>“Article 4 Compensation for losses</p> <p>[...]</p> <p>2. Without prejudice to paragraph 1 of this Article, investors of one Contracting Party who, in any of the situations referred to in that paragraph, suffer losses in the territory of the other Contracting Party resulting from:</p> <p>(a) requisitioning of their property by its forces or authorities; or</p> <p>(b) destruction of their property by its forces or authorities which was not caused in combat action or was not required by the necessity of the situation, <b>shall be accorded restitution or adequate compensation no less favourable than that which would be accorded under the same circumstances to an investor of the other Contracting Party or to an investor of any third State.</b> Resulting payments shall be freely transferable without undue delay.” (emphasis added)</p>	<p>“Article 7 Compensation for losses</p> <p>[...]</p> <p>2. Without prejudice to paragraph 1 of this Article, an investor of a Contracting Party who, in any of the situations referred to in that paragraph, suffers a loss in the territory of the other Contracting Party resulting from requisitioning or destruction of its property by the armed forces or other authorities of the latter Contracting Party, which was not caused in combat action or was not required by the necessity of the situation, <b>shall be accorded such compensation as may be provided by its laws.</b>” (emphasis added)</p>

## H. Transfer of funds

The transfer provisions included in most BITs are particularly important for foreign investors, as they see the timely transfer of profits, capital and other payments as a key condition for the proper operation of their investments (UNCTAD 2000b). However, in an increasingly interdependent international economy, countries need to be able to regulate capital inflows or outflows appropriately. Some economies, especially those of developing countries, may be particularly vulnerable to capital flight, as well as to sudden large capital inflows into their economies.

Transfer provisions in BITs have traditionally reflected a tension between two different objectives: on the one hand, to grant the investor the freedom of investment-related transfers of funds, and, on the other hand, to provide the host country with enough flexibility to properly administer its monetary and financial policies. Thus, a significant number of BITs have included provisions granting investors the right to make capital transfers in relation to their investment without undue delay, in a freely convertible currency and at a specified rate of exchange. At the same time, a large number of BITs have included exceptions to these obligations.

BITs concluded since 1995 have followed the same trend, although their transfer provisions vary in scope, content and degree of specificity.

## 1. Scope of the transfer provision

Most BITs include transfer clauses that guarantee investors the right to transfer funds related to an investment without delay, and to use a particular kind of currency at a specified exchange rate. Within these general parameters, several issues arise. There is the question whether the transfer right should apply only to transfers out of the host country or also to inbound transfers. Second, should the transfer provision apply to all funds related to an investment or only to those explicitly listed in the transfer provision? And third, should the guarantee be subject to domestic laws and regulations?

### a. Coverage of inbound and outbound transfers of funds?

A first group of BITs contain a transfer clause covering only transfers of funds out of the host country. The BIT between Belgium–Luxembourg and Hong Kong (China) (1996) is a case in point:

*“Article 6  
Transfers of Investments and Returns*

*(1) Each Contracting Party shall in respect of investments guarantee to investors of the other Contracting Party the unrestricted right to **transfer** their investments and returns **abroad**. [...]* (emphasis added)

The inclusion of the right to make transfers *into* the host country is more common in BITs granting the investor a right of establishment. As most BITs do not go so far, the transfer clause usually focuses on the stage once the investment has been undertaken.

A second group of BITs contain transfer clauses that explicitly apply to inbound and outbound transfers. The BIT between Japan and Viet Nam (2003) demonstrates this concept:

*“Article 12*

*1. Each Contracting Party shall ensure that **all payments relating to investments** in its Area of an investor of the other Contracting Party **may be freely transferred into and out** of its Area without delay. Such transfers shall include, in particular, though not exclusively [...]* (emphasis added)

Another category of BITs has transfer clauses that do not explicitly apply to inbound and outbound transfers, but nevertheless use language general enough to have this effect. The BIT between Malaysia and Saudi Arabia (2000) embodies this frequently used approach.

*“Article 6  
Transfers*

*Each Contracting Party shall guarantee to investors of the other Contracting Party, after all taxes and obligations have been met, **the free transfer of payments** in any freely usable currency **in connection with investments** and investment returns they hold in the territory of the other Contracting Party, in particular: [...]* (emphasis added)

Other BITs include similar wording, but the title of the provision makes reference only to “repatriation of investments and returns”. In such situations, there are doubts about the scope of the provision. An example is the BIT between Ghana and India (2002):<sup>84</sup>

*“Article 7  
Repatriation of Investment and Returns*

*(1) Each Contracting Party shall permit **all funds** of an investor of the other Contracting Party **related to an investment** in its territory **to be freely transferred**, without unreasonable delay and on a non-discriminatory basis. Such funds may include: [...]* (emphasis added)

It should be mentioned that the last three types of provisions add a list of covered transfers. This helps to determine whether the article applies to outbound and/or inbound transfers.

#### b. Open-ended vs. closed list of covered transfers

There is the issue of whether the transfer clause should apply to all funds related to an investment or only to those explicitly agreed by the parties. One group of recent BITs contains a transfer clause covering in an *illustrative list* all funds related to an investment. This general concept has been used by far the most frequently, for instance in the BIT between Mauritius and Singapore (2000):

“Article 8  
Repatriation

1. Each Contracting Party shall **guarantee** to investors of the other Contracting Party **the free transfer, on a non-discriminatory basis, of their capital and the returns from any investments.** The transfers shall be made in a freely convertible currency, without any restriction or undue delay. **Such transfers shall include in particular, though not exclusively:**
  - (a) profits, capital gains, dividends, royalties, interest and other current income accruing from an investment;
  - (b) the proceeds of the total or partial liquidation of an investment;
  - (c) repayments made pursuant to a loan agreement in connection with an investment;
  - (d) license fees in relation to the matters in Article 1 (1) (d);
  - (e) payments in respect of technical assistance, technical service and management fees;
  - (f) payments in connection with contracting projects ;
  - (g) earnings of nationals of a Contracting Party who work in connection with an investment in the territory of the other Contracting Party. [...] (emphasis added)

Another group of BITs limits the transfer right to those specific funds included in an *exhaustive list*. The BIT between Cuba and Denmark (2001) illustrates this idea:

“Article 8  
Transfer of capital and returns

- (1) Each Contracting Party shall with respect to investments in its territory by investors of the other Contracting Party allow the free transfer in and out of its territory of:
  - (a) the initial capital and any additional capital for the maintenance and development of the investment;
  - (b) the investment capital or the proceeds from the sale or liquidation of all or any part of an investment;
  - (c) interests, dividends, profits and other returns realized; payments made for the reimbursement of the credits for Investments, and interests due;
  - (d) payments derived from rights enumerated in Article 1, section 1, of this Agreement;
  - (e) unspent earnings and other remunerations of personnel engaged in connection with an investment;
  - (f) compensation, restitution, indemnification or other settlement pursuant to articles 6 and 7. [...]

The wording of this article is very general, and comprises most of the possible kinds of transfers that an investor might need to make.<sup>85</sup> Thus, the practical differences between the two alternatives might not be very substantial. However, by covering all funds related to an investment the first concept allows for the possibility of covering new kinds of funds which, although not currently envisaged, may yet develop in the future.



**c. Should the scope of the guarantee be limited only by the agreement and other applicable international rules or also by domestic legislation?**

There is the question of whether the transfer guarantee should be a self-standing obligation, limited only by the exceptions included in the BIT and other applicable international rules, such as the IMF Agreement, or instead be subject to the domestic laws and regulations of the host country. BITs under review have followed two main concepts.

Numerous agreements do not subject the guarantee to the domestic legislation of the host country.<sup>86</sup> Other BITs follow the opposite idea. The BIT between China and Djibouti (2003) provides an example:

*“Article 6  
Repatriation of investments and returns*

- 1. Each Contracting Party shall, **subject to its laws and regulations**, guarantee to the investors of the other Contracting Party the transfer of their investments and returns held in its territory, including: [...]” (emphasis added)*

This approach reduces the level of investment protection considerably. It might also generate uncertainty among investors, not only because they might be unfamiliar with the applicable laws and regulations, but also because such laws and regulations may change from time to time.

## 2. Standards of protection

Several aspects are of particular relevance in this regard. First, the type of currency in which the transfers are to be allowed; second, the exchange rate that will apply for currency conversions; and third, the time frame in which the transfers will be effected. Recent BITs differ with regard to each of these issues.

### a. Type of currency

For the host country it is not the same to have complete freedom concerning the currency in which it will honour its transfer obligation, or to be obliged to allow transfers in a particular currency.

A group of BITs under review provide that transfers shall be permitted in any freely convertible currency. The BIT between Greece and Mexico (2000) typifies this widely used concept:

*“Article 7  
Transfers*

- 1. Each Contracting Party shall guarantee the right that payments relating to an investment may be transferred. The transfers shall be effected without delay, **in a freely convertible currency**, at the market rate of exchange applicable on the date of transfer [...]” (emphasis added)*

Another category of BITs is more restrictive. They provide that the transfer shall be permitted in the currency in which the investment was originally made or in any convertible currency agreed by the parties. The BIT between Brunei Darussalam and China (2000) exemplifies this mode:

*“Article 6  
Repatriation*

- [...]
- 2. Transfers of currency shall be made without delay **in the convertible currency in which the capital was originally invested or in any other convertible currency agreed by the relevant investors of one Contracting Party and the other Contracting Party**. [...]” (emphasis added)*

This technique provides a degree of flexibility in the sense that it allows the host country to agree with the investor on the currency to be used. If such agreement cannot be reached, transfers shall be effected in the currency in which the capital was originally invested. If the capital was originally invested in domestic currency, the host country would not need to use its foreign exchange reserves to comply with the obligation.

Under another method transfers shall be permitted in any *freely usable* currency, that is only in those “hard” currencies widely traded in the international markets and recognized as such by the IMF. The BIT between Egypt and Malaysia (1997) illustrates this method:

*“Article 6  
Transfers*

*Each Contracting Party shall, subject to its laws, regulations and national policies, allow without unreasonable delay the transfer in **any freely usable currency**: [...]*” (emphasis added)

This BIT also defines in its article 1.1.(e) “*freely usable currency*” as follows:

*“(e) “freely usable currency” means the United States dollar, Pound sterling, Deutschemark, French franc, Japanese yen or any other currency that is widely used to make payments for international transactions and widely traded in the international principal exchange markets.”*

This approach regarding the kind of currency to be used for transfer purposes provides greater protection to the investor and less discretion to the host country, since it substantially reduces the number of currencies that could be used for complying with the obligation. Furthermore, this method may entail a more stringent obligation on the part of the host country, as it may need to use its reserves to convert its domestic currency into a freely usable one.

## b. Exchange rate

A key aspect that many BITs address is the specific exchange rate to be applied for the conversion of domestic currency. It may not be the same to use an official rate of exchange subject to the control of the host country, or other exchange rates, such as the market rate of exchange or exchange rates calculated using particular international criteria.

A limited number of BITs concluded since 1995 do not address this issue at all.<sup>87</sup> A second group of BITs address the issue of the applicable exchange rate; however, they do not specify whether transfers shall be made on the basis of official or market rates of exchange. The BIT between Sierra Leone and the United Kingdom (2000) is an example:

*“Article 6  
Repatriation of Investment and Returns*

*Each Contracting Party shall in respect of investments guarantee to nationals or companies of the other Contracting Party the unrestricted transfer of their investments and returns. Transfers shall be effected without delay in the convertible currency in which the capital was originally invested or in any other convertible currency agreed by the investor and the Contracting Party concerned. **Unless otherwise agreed by the investor transfers shall be made at the rate of exchange applicable on the date of transfer pursuant to the exchange regulations in force.***” (emphasis added)

This method basically delegates the determination of the applicable exchange rates for purposes of transfers to the domestic legislation of the host country. If the host country has a “freely floating” currency, regardless of whether there is an official exchange rate, the market will ultimately determine the applicable exchange rate. However, if the host country has an overvalued or undervalued official exchange rate, investors would be favoured (disfavoured), since they would receive a higher (lower) amount than under a market rate.

A third group of BITs specify that the applicable exchange rates shall be the market rate of exchange existing on the date of the transfer. For instance, the BIT between Austria and the Philippines (2002) states:

*“Article 6  
Transfers*

[...]

(2) *The payments referred to in this Article shall be effected at **the market rate of exchange prevailing on the day of the transfer.***

(3) *The **rates of exchange shall be determined according to the quotations on the stock exchanges or in the absence of such quotations according to the spot transactions conducted through the respective banking system in the territory of the respective Contracting Party.** [...]* (emphasis added)

Some BITs within this category provide for alternatives in case a market rate of exchange does not exist. For example, the BIT between Brunei Darussalam and China (2000) provides as follows:

*“Article 6  
Repatriation*

[...]

2. *Transfers of currency shall be made without delay in the convertible currency in which the capital was originally invested or in any other convertible currency agreed by the relevant investors of one Contracting Party and the other Contracting Party. Transfers shall be made at the market rate of exchange of the Contracting Party accepting the investment on the date of transfer. **In the event that the market rate of exchange does not exist, the rate of exchange shall correspond to the cross rate obtained from those rates which would be applied by the International Monetary Fund on the date of payment for conversions of the currencies concerned into Special Drawing Rights.*** (emphasis added)

### c. Timing of transfer

Most BITs contain an obligation on the part of the host country to permit the transfers "without unreasonable delay".<sup>88</sup> The undefined term "unreasonable delay" would have to be determined on a case-by-case basis.

Other BITs provide more guidance. The BIT between Belgium–Luxembourg and Pakistan (1998) is an example:

*“Article 7  
Transfer*

[...]

4. *The Contracting Parties undertake to facilitate the procedures needed to make these transfers without delays according to the practices in international financial centers. **In particular no more than three months must elapse from the date on which the investor properly submits the necessary applications in order to make the transfer until the date on which the transfer actually takes place.** Therefore both Contracting Parties undertake to carry out the required formalities both for the acquisition of foreign currency and for its effective transfer abroad within that period of time.* (emphasis added)

Several BITs in this category provide for shorter or longer periods for the host country to process the transfer.<sup>89</sup> Despite these differences, all these BITs coincide in establishing objective time frames to assess whether the host country has actually complied with the obligation to allow transfers without delay.

### 3. Exceptions

The right of free transfer of funds has to be interpreted in consonance with the other provisions of BITs. Among the BITs under review, a large number include different kinds of specific exceptions to the transfer article.

One group indicates that the transfer provision does not prevent contracting parties from ensuring compliance with other measures relating to matters such as bankruptcy, trading in securities, criminal acts or compliance with resolutions of tribunals. The BIT between Mexico and the Republic of Korea (2000) is a case in point:

*“Article 6  
Transfers*

[...]

- (3) *Notwithstanding paragraphs 1 and 2 above, a Contracting Party may prevent a transfer through the equitable, non-discriminatory and in good faith application of its laws relating to:*
- (a) *bankruptcy, insolvency or other legal proceedings to protect the rights of creditors;*
  - (b) *issuing, trading or dealing in securities;*
  - (c) *criminal or administrative violations; or*
  - (d) *ensuring the satisfaction of judgements in adjudicatory proceedings.”*

Recent BITs have increasingly used this concept. Among others, BITs negotiated by Australia, Canada, Japan, the United States, Mexico and some other Latin American countries include this specific exception — which in some cases also encompasses the right to apply laws related to reports on transfers for statistical purposes.

The second category of exceptions comprises those aimed at safeguarding flexibility for host countries to properly administer financial and monetary policies. One group of BITs specifically addresses the problem of speculative capital inflows. A related exception has been included in BITs of Chile, which for many years applied a law requiring all capital inflows to remain in the country for at least one year.<sup>90</sup> The protocol of the BIT between Austria and Chile (1997) illustrates this idea:

*“Protocol*

[...]

*Ad Article 4*

- (1) *Capital can only be transferred one year after it has entered the territory of the Contracting Party unless its legislation provides for a more favourable treatment. [...]*”

Another kind of exception included in various BITs relates to balance-of-payments (“BoP”) crises. Many – if not most – of the more recent investment disputes have arisen in connection with such crises. The “BoP exception” is tailored for situations in which the host country passes through a period when foreign currency reserves are at exceptionally low levels and when it thus becomes extremely difficult to convert and transfer funds related to investments. The BIT between Japan and Viet Nam (2003) shows in great detail the substantive elements of a “BoP” exception:

*“Article 16*

1. *A Contracting Party may adopt or maintain measures not conforming with its obligations under paragraph 1 of Article 2 relating to cross-border capital transactions and Article 12:*
- (a) *in the event of serious balance-of-payments and external financial difficulties or threat thereof; or*
  - (b) *in cases where, in exceptional circumstances, movements of capital cause or threaten to cause serious difficulties for macroeconomic management, in particular, monetary and exchange rate policies.*

2. *Measures referred to in paragraph 1 above:*
  - (a) *shall be consistent with the Articles of Agreement of the International Monetary Fund so long as the Contracting Party taking the measures is a party to the said Articles;*
  - (b) *shall not exceed those necessary to deal with the circumstances set out in paragraph 1 above;*
  - (c) *shall be temporary and shall be eliminated as soon as conditions permit; and*
  - (d) *shall be promptly notified to the other Contracting Party.*
3. *Nothing in this Agreement shall be regarded as altering the rights enjoyed and obligations undertaken by a Contracting Party as a party to the International Monetary Fund."*

The BIT between Greece and Mexico (2000) represents a shorter version of the "BoP" exception and provides that:

*"Article 7*

[...]

4. *In case of a serious balance of payments difficulties or the threat thereof, each Contracting Party may temporarily restrict transfers, provided that such a Contracting Party implements measures or a programme in accordance with the International Monetary Fund's standards. These restrictions would be imposed on an equitable, non-discriminatory and in good faith basis."*

The majority of the BITs under review do not contain a "BoP" exception. One explanation might be that Governments do not consider limiting transfers as the most appropriate mechanism for coping with shortages of international reserves. It has been argued that to restrict international transfers in times of crisis exacerbates the anxieties of foreign and domestic investors alike, and might foster creative means for the latter to circumvent those limitations.

A third kind of exception, which has been used in some recent BITs — in particular those of Canada, Japan and the United States — includes financial services within their scope of application. In many countries, financial services are heavily regulated and subject to close supervision by regulatory authorities.<sup>91</sup> Thus, in order to prevent any BIT obligation from interfering with such regulatory powers, a number of agreements have included an exception safeguarding those prerogatives. The 2004 Canadian model BIT demonstrates this mode:

*"Article 14  
Transfer of Funds*

[...]

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

\* \* \*

The trend in the evolution of transfer provisions in BITs reflects a dual pattern. A limited number of BITs contain innovations regarding the scope and content of the clause and exceptions to it, while another — more numerous — group of agreements have followed traditional concepts developed in different historical contexts. During the last 10 years, the drafting of transfer clauses has focused on how to strike a balance between the interests of the investors and those of the host countries.

## I. Other specific clauses

### 1. Performance requirements

Performance requirements are conditions imposed by host countries on investors in connection with the establishment and operation of investments or in exchange for the granting of a particular advantage (UNCTAD 2001a). The rationale for a country to use performance requirements is to induce certain investor behaviour in pursuance of particular policy objectives. They are implemented with the aim of influencing the location and character of investment and, in particular, its costs and benefits. Within this logic, performance requirements may aim at, for example, generating employment, increasing the demand for local inputs, boosting exports or augmenting foreign exchange.

Historically, numerous developed and developing countries have imposed performance requirements on foreign investors as a condition for allowing them to invest in their territories. These countries have been considering performance requirements as an important policy tool to further their development objectives by modifying the behaviour of foreign investors and to steer them into the desired direction. Other countries, instead, have persuaded investors to accept performance requirements voluntarily by linking them to the granting of incentives (UNCTAD 2003a). Among the most common performance requirements were those that include obligations to hire nationals of the host country, to use locally produced raw materials or inputs, and to export a portion of the finished product (UNCTAD 1998).

The main criticism of the use of performance requirements — especially making the entry of foreign investors conditional on compliance with them — is that they would deter foreign investment rather than being instruments to achieve the desired policy objectives. It is argued that most often, the objectives pursued through performance requirements — such as an increase in exports or generation of employment — cannot be achieved via decree, but are rather the result of a complex mix of policies and variables. Furthermore, it is argued that performance requirements are a disincentive for foreign investors, who refrain from investing under conditions impeding the free management of their investments and forcing them to conduct business in ways that reduce their efficiency (UNCTAD 1998).

Regardless of which particular school of thought one follows, it has been widely recognized that at least some performance requirements may have distorting effects on international trade. Such recognition led to the adoption of the WTO Agreement on Trade-Related Investment Measures (TRIMs). This treaty prohibits performance requirements inconsistent with two main GATT obligations, namely article III, which establishes the obligation of national treatment, and article XI, which contains the obligation to eliminate quantitative restrictions. The treaty applies only to the goods sector. The annex to the TRIMs Agreement provides an illustrative list of the kinds of performance requirements inconsistent with these two obligations. In particular, it states the following:

*“Annex  
Illustrative list*

1. *TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require:*
  - (a) *the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production; or*
  - (b) *that an enterprise’s purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports.*
2. *TRIMs that are inconsistent with the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which restrict:*

- (a) *the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports;*
- (b) *the importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise; or*
- (c) *the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production.”*

The WTO has 150 member countries; in addition, 31 countries have observer status, with most of them in the process of accession.<sup>92</sup> The TRIMs Agreement constitutes a normative landmark in the international regulation of performance requirements, and — as will be explained below — also has an important effect on numerous BITs.

Traditionally, most BITs did not include any explicit disciplines on performance requirements. However, this does not mean that the use of such requirements was not constrained by other provisions of these agreements. If a performance requirement were applied only to foreign investors after the investment had been admitted into the host country, such a practice would be inconsistent with the national treatment obligation. However, there would normally be no violation of a BIT if such a requirement were applied on a non-discriminatory basis, or imposed — even on a discriminatory basis — as a condition for the admission of the investment.

In the last 10 years, an increasing number of BITs have included explicit disciplines on performance requirements. They aim at restricting the discretion of host countries in applying performance requirements. The level of disciplines tends to go beyond the level of the obligations included in the TRIMs Agreement.

#### **a. BITs with no explicit restriction on performance requirements**

The majority of recent BITs do not contain any specific provision on performance requirements. One might therefore conclude that contracting parties are free to use performance requirements as far as they are imposed as a condition for the establishment of the investment or applied afterwards on a non-discriminatory basis.

However, a significant number of BITs include an “application of other rules” provision, which seeks to ensure that the host country provides the investor with the most-favoured-treatment resulting from the application of its domestic laws or international obligations. The BIT between Germany and Thailand (2002) contains this widely used clause:<sup>93</sup>

*“Article 7  
Application of other Rules*

- (1) *If the laws and regulations of either Contracting Party or obligations under international law existing at present or established hereafter between the Contracting Party in addition to this Treaty contain provisions, whether general or specific, entitling investments by investors of the other Contracting Party to a treatment more favourable than is provided for by this Treaty, such provisions shall to the extent that they are more favourable prevail over this Treaty.*
- (2) *Each Contracting Party shall observe any other obligation it has assumed with regard to investments in its territory by investors of the other Contracting Party. ”*<sup>94</sup>

On the basis of the first paragraph of this provision, one could argue that, despite not including any specific discipline on performance requirements in the BIT, Germany and Thailand nevertheless have to observe their obligations deriving from their membership of the TRIMs Agreement. The latter agreement contains prohibitions on the use of performance requirements binding both Germany and Thailand under international law, and thereby entails a more favourable treatment for investments than that granted by the

BIT. Thus, according to article 7 cited above, the provisions of the TRIMs Agreement would prevail over the BIT to the extent that they are more favourable to the covered investors.

A question remains as to whether an investor would be entitled to enforce the rights derived from the TRIMs Agreement through the investor–State dispute settlement provisions in the BIT. There are arguments in favour and against this possibility. However, this particular issue could arise only if both contracting parties of a BIT are also Members of the WTO and therefore parties to the TRIMs Agreement.

#### **b. BITs with disciplines on performance requirements**

Several BITs concluded since 1995 explicitly deal with performance requirements.

One group of BITs restricts the use of performance requirements, but at the same time states that the obligations undertaken in this regard do not go beyond those assumed in the context of the TRIMs Agreement. An example of this approach is the BIT between Canada and Costa Rica (1998):

*“Article VI  
Performance Requirements*

*Neither Contracting Party may impose, in connection with permitting the establishment or acquisition of an investment, or enforce in connection with the subsequent regulation of that investment, any of the requirements set forth in the World Trade Organization Agreement on Trade-Related Investment Measures contained in the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, done at Marrakech on April 15, 1994.”*

Other BITs restrict the use of performance requirements in general terms. Most agreements falling in this subcategory are recent BITs of Finland — a country that usually includes a general restriction on the use of performance requirements in its BITs.<sup>95</sup> The BIT between Azerbaijan and Finland (2003) embodies this concept:

*“Article 2  
Promotion and Protection of Investments*

[...]

4. *Each Contracting Party shall not impose mandatory measures on investments by investors of the other Contracting Party concerning purchase of materials, means of production, operation, transport, marketing of its products or similar orders having unreasonable or discriminatory effects.”*

This technique restricts only performance requirements that are mandatory and applied after the investment has been established. As this BIT applies only to established investments, performance requirements imposed at the entry phase are not restricted, nor are they made conditional on the receipt of an advantage relating to establishment. In addition, this approach may restrict performance requirements affecting services — an issue not addressed by the TRIMs Agreement.

The third category of BITs restricts the use of performance requirements on the basis of an exhaustive positive list. Thus, the contracting parties assume the obligation to refrain only from those performance requirements explicitly listed in the provision. Furthermore, this mode limits the use of performance requirements both at the pre-establishment phase of the investment and thereafter. Only compulsory performance requirements are restricted; the contracting parties being left with discretion to impose them as a condition for the receipt of investment incentives. Finally, the disciplines apply not only to investment in goods, but also to investment in services.

Most of the Canadian and United States BITs at the end of the 1990s follow this approach.<sup>96</sup> The BIT between Bahrain and the United States (1999) provides an illustration:



*“Article 6*

*Neither Party shall mandate or enforce, as a condition for the establishment, acquisition, expansion, management, conduct or operation of a covered investment, any requirement (including but not limited to, any commitment or undertaking in connection with the receipt of a governmental permission or authorization):*

- (a) to achieve a particular level or percentage of local content, or to purchase, use or otherwise give a preference to products or services of domestic origin or from any domestic source;*
- (b) to limit imports by the investment of products or services in relation to a particular volume or value of production, exports or foreign exchange earnings;*
- (c) to export a particular type, level or percentage of products or services, either generally or to a specific market region;*
- (d) to limit sales by the investment of products or services in the Party’s territory in relation to a particular volume or value of production, exports or foreign exchange earnings;*
- (e) to transfer technology, a production process or other proprietary knowledge to a national or company in the Party’s territory, except pursuant to an order, commitment or undertaking that is enforced by a court, administrative tribunal or competition authority to remedy an alleged or adjudicated violation of competition laws; or*
- (f) to carry out a particular type, level or percentage of research and development in the Party’s territory.*

*Such requirements do not include conditions for the receipt or continued receipt of an advantage.”*

Another group of BITs comprises agreements with sophisticated and detailed clauses. This approach resembles in several aspects the one used in the BITs included in the third group. The provisions on performance requirements are also based on a positive list approach, apply to both the pre-and post-establishment phases of the investment and restrict performance requirements affecting investment in goods and services. However, this fourth category goes one step further. It not only includes additional restrictions on the use of performance requirements, but also — in consonance with the TRIMs Agreement — prevents the host country from using *certain* performance requirements as a condition for granting advantages or incentives.

This approach is mainly used in recent BITs of Japan, such as the agreements with the Republic of Korea (2002) and Viet Nam (2003):

*“Article 4*

- 1. Neither Contracting Party shall impose or enforce, as a condition for investment activities in its Area of an investor of the other Contracting Party, any of the following requirements:*
  - (a) to export a given level or percentage of goods or services;*
  - (b) to achieve a given level or percentage of domestic content;*
  - (c) to purchase, use or accord a preference to goods produced or services provided in its Area, or to purchase goods or services from natural or legal persons or any other entity in its Area;*
  - (d) to relate the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with investments of that investor;*
  - (e) to restrict sales of goods or services in its Area that investments of that investor produces or provides by relating such sales to the volume or value of its exports or foreign exchange earnings;*
  - (f) to appoint, as executives, managers or members of boards of directors, individuals of any particular nationality;*
  - (g) to transfer technology, a production process or other proprietary knowledge to a natural or legal person or any other entity in its Area, except when the requirement (i) is imposed or enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws; or (ii) concerns the transfer of intellectual property rights which is undertaken in a manner not inconsistent with the Agreement on Trade-Related*

*Aspects of Intellectual Property Rights, Annex 1C of the Marrakesh Agreement Establishing the World Trade Organization;*

- (h) *to locate the headquarters of that investor for a specific region or the world market in its Area;*
  - (i) *to achieve a given level or value of research and development in its Area; or*
  - (j) *to supply one or more of the goods that the investor produces or the services that the investor provides to a specific region or the world market, exclusively from the Area of the former Contracting Party.*
2. *The provisions of paragraph 1 above do not preclude either Contracting Party from conditioning the receipt or continued receipt of an advantage, in connection with investment activities in its Area of an investor of the other Contracting Party, on compliance with any of the requirements set forth in paragraph 1 (f) through (j) above.”*

Because of the level of detail and scope of the obligation, BITs included in this fourth category allow contracting parties to make reservations at the time of the negotiation. They can exempt existing non-conforming measures or exclude a particular sector from the scope of application of the disciplines on performance requirements.

Another group of BITs contains the most detailed and far-reaching obligations on this subject. Among the BITs applying this approach are recent agreements between Cuba and Mexico (2001), the United States and Uruguay (2005), and the 2004 Canadian model BIT.

Basically, these agreements follow the same concept as the BITs included in the fourth category. However, there are some minor distinctions.

One relates to the scope of application of the obligation on performance requirements. The agreements included in the fourth category establish the obligation of the contracting parties to refrain from imposing certain enumerated performance requirements. The BITs included in the fifth category go one step further, and oblige the contracting parties to refrain from imposing the banned performance requirements not only on each other's investments and investors, but also on investments and investors of any third country. The rationale for this is to ensure a single investment policy of each contracting party concerning all investments regardless of their origin, and thereby to foster a more uniform level playing field for foreign investors.

Another distinction relates to the level of detail with which the provision is drafted. Clauses in the fifth category are typically very elaborate. They list the compulsory performance requirements from which the contracting parties shall abstain in connection with the establishment or operation of the covered investments. They also include the performance requirements from which the contracting parties shall refrain in connection with the granting of an incentive or other advantage. The provisions contain a series of exceptions to the obligations included in the previous two sections. In this regard, it is worth noting the intent of the parties not to impair the regulatory powers of the host country in order to pursue a series of legitimate policy objectives. The 2004 Canadian model BIT provides as follows:

*“Article 7  
Performance Requirements*

- 1. *Neither Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or a non-Party in its territory:*
  - (a) *to export a given level or percentage of goods;*
  - (b) *to achieve a given level or percentage of domestic content;*
  - (c) *to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;*
  - (d) *to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;*

- (e) *to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;*
  - (f) *to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority, to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement; or*
  - (g) *to supply exclusively from the territory of the Party the goods it produces or the services it provides to a specific regional market or to the world market.*
2. *A measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements shall not be construed to be inconsistent with paragraph 1(f). For greater certainty, Articles 3 and 4 apply to the measure.*
  3. *Neither Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements:*
    - (a) *to achieve a given level or percentage of domestic content;*
    - (b) *to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory;*
    - (c) *to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or*
    - (d) *to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.*
  4. *Nothing in paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party, on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory.*
  5. *Paragraphs 1 and 3 shall not apply to any requirement other than the requirements set out in those paragraphs.*
  6. *The provisions of:*
    - (a) *Paragraphs (1) (a), (b) and (c), and (3) (a) and (b) shall not apply to qualification requirements for goods or services with respect to export promotion and foreign aid programs;*
    - (b) *Paragraphs (1) (b), (c), (f) and (g), and (3) (a) and (b) shall not apply to procurement by a Party or a state enterprise; and*
    - (c) *Paragraphs (3) (a) and (b) shall not apply to requirements imposed by an importing Party relating to the content of goods necessary to qualify for preferential tariffs or preferential quotas.”*

## **2. Entry and sojourn of foreign nationals**

The proper functioning of a foreign subsidiary may require not only the possibility for investors to visit the site of the investment frequently, but also the presence in the host country of expatriate personnel for extended periods of time. Accordingly, there is an increasing demand not only to allow cross-border flows of capital, but also to facilitate the international movement of people.

The interests of the investors, however, do not necessarily converge with immigration policies of host countries, which aim at granting domestic authorities ample discretion as to whether to allow the entry of foreign nationals into their territory.

BITs provide, in general, little assistance to foreign investors on this issue.<sup>97</sup> To the extent that agreements include provisions on the subject, they usually refrain from establishing legally binding obligations of the contracting parties to allow the entry and sojourn of covered investors or investment-related personnel. Most BITs have not gone further than including “best efforts” clauses subject to national legislation. This trend has continued among the BITs under review.

One group of BITs, which is relatively numerous, does not deal with this matter at all. Other BITs include a specific clause, but fall short of establishing any right of entry for the investor or investment-related personnel. Different modes are used within this category of agreements. The most important distinction relates to the question of whether the relevant provision covers only nationals of the other contracting party or any foreign personnel employed by the foreign investor (table 20).

**Table 20. Examples of provisions on entry and sojourn of foreign nationals**

BIT between Botswana and China (2000)	BIT between Bosnia Herzegovina and Germany (2001)	BIT between Australia and India (1999)	BIT between France and Mexico (1998)
<p>“Article 2 Promotion and Protection of Investment</p> <p>[...] 4. Subject to its laws and regulations, one Contracting Party shall provide assistance in and facilities for obtaining visas and work permits for <b>nationals of the other Contracting Party</b> engaging in activities associated with investments made in the territory of that Contracting Party.” (emphasis added)</p>	<p>“Protocol to the Treaty between the Federal Republic of Germany and Bosnia Herzegovina concerning the Encouragement and Reciprocal Protection of Investments</p> <p>[...] (2) Ad Article 3 [...] (c) The Contracting States shall within the framework of their national legislation give sympathetic consideration to applications for the entry and sojourn of <b>persons of either Contracting State</b> who wish to enter the territory of the other Contracting State in connection with an investment; the same shall apply to employed <b>persons of either Contracting State</b> who in connection with an investment wish to enter the territory of the other Contracting State and sojourn there to take up employment. Applications for work permits shall also be given sympathetic consideration.” (emphasis added)</p>	<p>“Article 5 Entry and sojourn of personnel</p> <p>1. A Contracting Party shall, subject to its laws applicable from time to time relating to the entry and sojourn of non-citizens, permit natural persons who are investors of the other Contracting Party and <b>personnel employed by companies of that other Contracting Party</b> to enter and remain in its territory for the purpose of engaging in activities connected with investments. [...].” (emphasis added)</p>	<p>“Article 4 Protection and treatment of investments</p> <p>[...] 4. Within the framework of their internal legislation, the Contracting Parties shall benevolently examine requests for entry and authorization to reside, work and travel made by <b>the nationals of one Contracting Party</b> in relation to an investment made in the territory or in the maritime area of the other Contracting Party.” (emphasis added)</p>

A third group of agreements provides some degree of discipline, although they do not oblige the contracting parties to allow the entry of foreign nationals into their territories and their sojourn therein. These treaties prohibit the host country from applying labour certification tests or similar procedures as well as any numerical restrictions relating to the temporary entry of businesspersons. The BIT between Japan and the Republic of Korea (2002) is an example:

*“Article 8*

1. *Subject to its laws relating to entry, stay and authorisation to work, each Contracting Party shall grant temporary entry, stay and authorisation to work to investors of the other Contracting Party for the purpose of establishing, developing, administering or advising on the operation in the territory of the former Contracting Party of an investment to which they, or an enterprise of that other Contracting Party that employs them, have committed or are in the process of committing a substantial amount of capital or other resources, so long as they continue to meet the requirements of this Article.*
2. *Neither Contracting Party, in granting entry under paragraph 1 of this Article, shall apply a numerical restriction in the form of quotas or the requirement of an economic needs test, unless (a) it notifies the other Contracting Party of its intent to apply the restriction no later than sixty days before the intended date of the implementation of the restriction, and (b) it, upon request by the other Contracting Party, consults with that other Contracting Party before the implementation of the restriction.*
3. *Neither Contracting Party shall require that an enterprise of that Contracting Party that is an investment of an investor of the other Contracting Party appoint, as executives, managers or members of boards of directors, individuals of any particular nationality.”*

Paragraph 2 of that provision states that although any permit for entry and sojourn is subject to domestic legislation, no contracting party shall apply quotas or economic needs tests. However, this obligation is not absolute, as any contracting party can apply such measures provided that it notifies and consults with the other contracting party before the restriction is imposed.

Not all BITs falling within this category contain such flexibility. Some agreements, notably several BITs of the United States concluded during the second part of the 1990s, include an absolute obligation for the contracting parties to abstain from imposing quotas or numerical restrictions when granting permits for the entry and sojourn of foreign nationals. The BIT between Nicaragua and the United States (1995) demonstrates this idea:

*“Article VII*

1. (a) *Subject to its laws relating to the entry and sojourn of aliens, each Party shall permit to enter and to remain in its territory nationals of the other Party for the purpose of establishing, developing, administering or advising on the operation of an investment to which they, or a company of the other Party that employs them, have committed or are in the process of committing a substantial amount of capital or other resources.*  
 (b) *Neither Party shall, in granting entry under paragraph 1(a), require a labor certification test or other procedures of similar effect, or apply any numerical restriction.*
2. *Each Party shall permit covered investments to engage top managerial personnel of their choice, regardless of nationality.”*

This method is an attempt to limit the discretion that immigration authorities have when granting permits for entry and sojourn to foreign investors. However, mainly as a result of South–North patterns of immigration, but also because of security concerns, most capital-exporting countries have gradually tightened their immigration policies. As far as the entry and sojourn of investors and investment-related personnel is concerned, the evolution in investment rulemaking has not only stagnated, but also might diminish in the future. The practice whereby there is included in the BIT an absolute obligation for the contracting parties to abstain from imposing quotas or numerical restrictions has already been discontinued by one of the few countries that used to follow this practice — the United States. The 2004 United States model BIT no longer includes a specific provision addressing the issue of temporary entry of foreign investors and personnel at all.

### 3. Top managerial personnel

Host countries might use compulsory legislation to ensure the participation of their nationals in the management or control of foreign investments. In some sectors, countries justify these policies on national security grounds, while in others Governments seek to ensure that their nationals receive technical training and managerial experience. These kinds of policies may conflict with the interests of investors, who would like to employ the most suitable managers regardless of their nationality.

Most BITs lack specific provisions on this matter.<sup>98</sup> However, more recently, a number of countries have started to include disciplines on top managerial personnel in their treaties.

Subject to the domestic legislation of the contracting party concerned, some BITs allow foreign investors and their *existing* personnel, *regardless of nationality*, to enter and remain in the host country. In addition, these BITs permit foreign investors to employ *new* key technical and managerial personnel of their choice — *regardless of nationality* — unless the legislation of the host country states otherwise. The BIT between Australia and Egypt (2001) is an example:

*“Article 5  
Entry and sojourn of personnel*

1. *Each Party shall, subject to its laws applicable from time to time relating to the entry and sojourn of non-citizens, permit natural persons who are investors of the other Party and personnel employed by companies of that other Party to enter and remain in its territory for the purpose of engaging in activities connected with investments.*
2. *Each Party shall, subject to its laws applicable from time to time, permit investors of the other Party who have made investments in the territory of the first Party to employ within its territory key technical and managerial personnel of their choice **regardless of citizenship.**”* (emphasis added)

Another group of agreements provides, at least in principle, the investor with the right to employ top managerial personnel regardless of nationality, without making it subject to domestic legislation.<sup>99</sup> The BIT between Lithuania and the United States (1998) illustrates this concept:

*“Article II*

[...]

5. *Companies which are legally constituted under the applicable laws or regulations of one Party, and which are investments, shall be permitted to engage top managerial personnel of their choice, regardless of nationality.”*

A further category of BITs addresses the issue of top managerial personnel in the framework of the prohibition of certain performance requirements. The BIT between Japan and Viet Nam (2003) is an illustration:

*“Article 4*

1. *Neither Contracting Party shall impose or enforce, as a condition for investment activities in its Area of an investor of the other Contracting Party, any of the following requirements:*

[...]

- (f) *to appoint, as executives, managers or members of boards of directors, individuals of any particular nationality; [...]*”

This concept makes a distinction between managers and members of the board of directors — a differentiation not made in the previous category of BITs. However, regardless of this distinction, the agreement provides the investor with the same treatment concerning these two groups.

This method contrasts with other BITs, which include a specific provision on top managerial personnel and also make a distinction between the latter and members of boards of directors. In this group of agreements, the distinction is used to differentiate between the treatment given to the two categories. Thus, while the host country is prohibited from imposing the obligation to employ top managerial personnel of a specific nationality on the investor, it can do this with regard to the members of the board of directors. In this latter case, the host country is allowed to require the directors to have a particular nationality, provided, however, that such requirement does not materially impair the investor's control of the investment. The BIT between Canada and El Salvador (1999) exemplifies this approach:

*“Article V  
Management, Directors and Entry of Personnel*

*A Contracting Party may not require that an enterprise of that Contracting Party, that is an investment under this Agreement, appoint to senior management positions individuals of any particular nationality.*

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

*Subject to its laws, regulations and policies relating to the entry of aliens, each Contracting Party shall grant temporary entry to citizens of the other Contracting Party employed by an enterprise who seeks to render services to that enterprise or a subsidiary or affiliate thereof, in a capacity that is managerial or executive or requires specialized knowledge.”*

Regardless of which mode a BIT follows, any provision giving foreign investors the possibility of appointing top managerial personnel of their choice has a significant caveat. No BIT under review provides foreign nationals with an unrestricted right of entry into the territory of the host country. Clauses on top managerial personnel do not prevail over the host country's immigration laws. Thus, any entry of particular foreign personnel will, in the end, be subject to domestic legislation.

#### 4. “Umbrella” clauses

Under “umbrella” clause provisions the host country usually assumes the responsibility to respect other obligations it has with regard to investments of investors of the other contracting party. It is estimated that of the almost 2,500 BITs currently in existence approximately 40 per cent contain such an “umbrella” or “respect” clause.<sup>100</sup> While umbrella clauses have not been a very prominent feature of BITs for many years, a large number of recent investment disputes have emerged in connection with such a provision.

A considerable variety of approaches can be found in BITs containing an umbrella clause (table 21).

**Table 21. Examples of "umbrella" clauses**

<b>BIT between Belarus and the Republic of Korea (1997)</b>	<b>BIT between Greece and Mexico (2000)</b>	<b>BIT between Italy and Jordan (1996)</b>
“Article 10 Application of other Rules	“Article 19 Application of other Rules	“Article 2 Promotion and Protection of Investments
[...] (3) Each Contracting Party <b>shall observe any other obligation</b> it may have entered into with regard to investments in its territory by investors of the other Contracting Party.” (emphasis added)	[...] Each Contracting Party shall observe any other obligation it may have entered into <b>in writing with regard to a specific investment</b> of an investor of the other Contracting Party. The disputes arising from such obligations shall be settled only under the terms and conditions of the respective contract. [...]” (emphasis added).	[...] 4. “Each contracting Party shall <b>create and maintain in its territory a legal framework</b> apt to guarantee to investors the continuity of legal treatment, including the <b>compliance, in good faith of all undertakings</b> assumed with regards to each specific investor.” (emphasis added)

It appears that the example of the BIT between the Republic of Korea and Belarus reflects the most frequently used type of an umbrella clause. It has a potentially broad scope of application (“any other obligation”), thereby giving relative ample protection to foreign investors. The other examples are more restrictive. One option is to protect only obligations made in writing. An additional restriction may be to cover only those obligations that are made in respect of a specific investment. Yet another possibility for limiting the scope of an umbrella clause is to introduce only an indirect obligation, as was done in the BIT between Italy and Jordan, which obliges the contracting parties to have domestic legislation in place that ensures that undertakings in respect of foreign investors are respected.

Another approach is to deal with the umbrella clause specifically in connection with dispute settlement. The objective is to restrict access to the dispute settlement mechanisms established under the BIT, thereby avoiding interference with dispute settlement rules in the individual investment contract between the foreign investor and the host country. An example is the above-mentioned BIT between Greece and Mexico (2000) or the BIT between Denmark and India (1995). The latter provides as follows:

“Article 2

[...]

4. *Each Contracting Party shall observe any obligation it has assumed with regard to investments in its territory by investors of the other Contracting Party, with disputes arising from such obligations being only redressed under the terms of the contracts underlying the obligations.*” (emphasis added)

An umbrella clause is no longer present in the 2004 model BIT of the United States. What is left is the right of a foreign investor to submit a claim in connection with an alleged breach of an “*investment agreement*” to international arbitration (article 24.1). However, submission requires the claimant’s written waiver to initiate or continue the claim before any domestic tribunals or courts of the host country (article 26). It appears that the deletion of the umbrella clause from the United States model BIT is at least partially a reaction to recent investment disputes involving this provision. It remains to be seen whether other countries will review the use of the umbrella clause in their BITs.

There is some uncertainty as to the precise nature and effect of umbrella clauses. On the one hand, it has been asserted that such provisions protect an investor’s contractual rights against “*any interference which might be caused by either a simple breach of contract or by administrative or legislative acts*” (Dolzer and Stevens 1995, p. 82). On the other hand, the precise scope of this obligation is unclear, in particular whether it also covers purely commercial contracts and what degree of specificity the host country’s commitment must have in order to become an obligation under international law.

This issue has generated some recent case law, above all two recent arbitral cases brought by the Swiss-based transnational corporation Société Générale de Surveillance (SGS) against Pakistan and the Philippines. In each case, the central question was whether, through the umbrella clause in the applicable BIT, the investor’s contractual claims against the host country (for breaches of contracts entered into for the provision of pre-shipment customs inspection services) could be resolved under the arbitration provisions of the BIT, rather than under the dispute resolution provisions of the contract in dispute.

The arbitral tribunal in *SGS v. Pakistan* held that, unless expressly stated, an umbrella clause does not derogate from the widely accepted international law principle that a contract breach is not by itself a violation of international law, particularly if such contract had a valid forum selection clause. The tribunal added that the umbrella clause was not a “first order” standard obligation; rather, it would provide a general pledge on the part of the host country to ensure the effectiveness of State contracts.<sup>101</sup>

The arbitral tribunal in *SGS v. the Philippines* interpreted the umbrella clause — which was not completely identical to the one in *SGS v. Pakistan* — in a way diametrically opposed to the interpretation adopted by the previous tribunal. It held that the umbrella clause did, in principle, have the effect of conferring jurisdiction on an arbitration tribunal constituted under the BIT to determine purely contractual



claims between an investor and the host country. The tribunal disagreed that the umbrella clause was merely a “second order” protection, preferring instead the view that the clause “means what it says”.<sup>102</sup>

The above cases do not offer a uniform or clear approach to the umbrella clause. From the perspective of an investor, the approach taken by the “Philippines tribunal” would offer greater protection, as it makes clear that a breach of a State contract amounts to a breach of a primary obligation in the BIT, placed upon the host country by the umbrella clause, to observe contractual commitments (Schreuer 2004, p. 255). On the other hand, the interpretation in the “Pakistan case” gives greater discretion to the host country to interfere with the contractual relationship with the investor and to have that action judged, not by reference to the mere fact of a breach of the underlying investment contract (which may well be entirely lawful under the national laws and policies of the host country), but by reference to other substantive treatment standards in the BIT. These require a more difficult standard of proof and, as a result, the protection offered by the BIT applies only where an investor meets that standard. It will not be met by reference to the breach of the State contract alone. Arguably, this approach could be seen as depriving the umbrella clause of any independent meaning, in that it would annul any possibility of viewing a breach of an obligation entered into by the host country under a State contract as amounting to a breach of the BIT by reason of an infringement of the umbrella clause (UNCTAD 2005e, pp. 19–23).

In conclusion, the diversity in the way in which the umbrella clause is formulated in BITs makes their proper interpretation dependent on each individual case. The review of the language of this clause indicates that although there are some disparities, the ordinary meaning of “shall observe any commitments/obligations” seems to point towards an inclusive, wide interpretation that would cover all obligations entered into by the contracting States, including contractual ones, unless otherwise stated. On the other hand, there are clauses that specifically narrow the scope of the umbrella clause, including with regard to dispute settlement. The majority of arbitral tribunals, with the exception of the two recent cases mentioned above, when faced with a “proper” umbrella clause, that is one drafted in broad and inclusive terms, seem to be adopting a fairly consistent interpretation which covers all State obligations, including contractual ones.<sup>103</sup>

## 5. Denial of benefits

Some BITs provide for the right of the contracting parties to deny the benefits of the agreement to investors who are from a third country. The issue of denial of benefits is closely related to the question of how to determine the legal entities considered as *investors* for the purposes of the BIT.

As explained in section B above, BITs use different criteria to ascribe nationality to legal entities. The inclusion of a denial-of-benefits clause particularly makes sense in those BITs that use the place of constitution as the only element to ascribe nationality to legal entities and to consider them to be investors for purposes of the agreement. The denial-of-benefits clause allows the BIT contracting parties to deny treaty protection to those companies that are controlled by investors of a non-party and have no substantial business activities in the territory of the party under whose laws they are constituted. The BIT between Azerbaijan and the United States (1997) illustrates this idea:

### *“Article XII*

*Each Party reserves the right to deny to a company of the other Party the benefits of this treaty if nationals of a third country own or control the company and*

- (a) the denying Party does not maintain normal economic relations with the third country; or*
- (b) the company does not have substantial business activities in the territory of the Party under whose laws it is constituted or organized.”*

Such a provision allows a contracting party of a BIT to deny the benefits of the agreement to a company that is a subsidiary of a shell company organized under the laws of the other contracting party if controlled by nationals of a third country (“letterbox” company). By contrast, a contracting party would not be permitted to deny the benefits to a company of the other contracting party that maintains its central

administration or principal place of business in the territory of the latter, or has a real and continuous link with that other contracting party, even if it is controlled by nationals of a third country.

Most BITs, however, do not contain a denial-of-benefits clause. This could allow investors from third countries to benefit from the agreement. This effect may not necessarily be against the interests of the contracting parties. For instance, small economies such as Singapore and Mauritius have used the “platform concept” under which they have been the base for third party foreign investment to be channelled into China or India, with which they have BITs. On the other hand, investors of non-parties might merely establish a shell company under the laws of a contracting party to benefit from treaty protection, unless the BIT requires that the assets be first located in the platform country.

The above article also makes it possible to avoid having to grant treaty protection to investors of countries with which a contracting party does not maintain normal economic relations. Such a denial-of-benefits clause would apply even in situations where investors of a non-party had not only constituted a company under the laws of the other contracting party but also maintained an effective business presence therein. The use of the denial-of-benefits clause in these circumstances may generate controversy in investment negotiations, as some countries consider that it unduly politicizes investment relations.

\* \* \*

To sum up, BITs concluded in the review period contain — to a varying extent — provisions on other issues, such as performance requirements, the entry and sojourn of foreign nationals, managerial personnel, the umbrella clause and denial of benefits. Disciplines on performance requirements are still rare, although the number of BITs including such clauses — which tend to go beyond the requirements of the TRIMS Agreement — is increasing. The situation is similar with regard to the entry, sojourn and employment of foreign nationals and key personnel. Unlike performance requirements, provisions on these issues are usually non-legally binding or subject to the domestic legislation of the host country. Relatively widespread is the use of “umbrella clauses” in BITs under review; they are usually drafted in broad terms and cover any other obligation that the host country has assumed with regard to the investor or the investment. It remains to be seen whether this trend will continue in the light of the numerous investment disputes that arose in connection with the umbrella clause in the last couple of years. By contrast, only a small group of BITs contains a denial-of-benefit clause excluding the applicability of the agreement under specific circumstances to investors from third countries

## **J. Transparency**

The issue of transparency is one of the areas where investment-rulemaking has evolved in the review period (UNCTAD 2004). The development has been more qualitative than quantitative. Although from a numerical perspective, most BITs have continued to lack any specific provision on transparency, among those agreements that do address the issue, there has been gradual and yet significant qualitative progress in the rationale and content of the obligations. While there has been a trend towards viewing transparency as an obligation imposed on countries to exchange information, new approaches also deem it to be a reciprocal obligation involving host countries and foreign investors. Furthermore, transparency obligations are no longer exclusively geared towards fostering exchange of information; rather, they relate to transparency in the process of domestic rulemaking, aimed at enabling interested investors and other stakeholders to participate in that process. In one arbitral award, it was held that transparency is required by the fair and equitable treatment clause.<sup>104</sup>

A survey of the transparency provisions in BITs concluded since 1995 reveals different concepts concerning their rationale. One approach conceives transparency as a commitment by countries to endeavour to inform each other about the existence of investment opportunities for investors of one contracting party in the territory of the other contracting party. The BIT between China and Jordan (2001) exemplifies this perception:

*“Article 2  
Promotion and admission of investments*

[...]

2. *In order to encourage mutual investment flows, each Contracting Party shall endeavour to inform the other Contracting Party, at the request of either Contracting Party on the investment opportunities in its territory.”*

Most other approaches used in BITs, however, do not focus on transparency concerning investment opportunities, but rather on laws, regulations and administrative practices applicable to foreign investment in the host country. Transparency is conceived as a tool to foster a more predictable investment climate, in which investors can clearly assess the conditions and rules applying to their investments.

BITs following this approach include obligations for the contracting parties to exchange information on laws and regulations governing investment in their respective territories. The transparency of laws and other governmental measures can be addressed from different perspectives, from publicizing all relevant acts and legislation in accordance with the host country's legal framework, to specifically notifying certain measures of one contracting party to officials of the other contracting party.

Some BITs focus on the obligation of the contracting parties to publish all measures that may affect investments. The BIT between Azerbaijan and Finland (2003) is an example:

*“Article 3  
Transparency*

*Each Contracting Party shall ensure that its laws, regulations, procedures, administrative rulings and judicial decisions of general application, as well as international agreements after their entry into force, which may affect the investments of investors of the other Contracting Party in its territory, are promptly published, or otherwise made publicly available.”*

Some recent BITs also provide for mechanisms to exchange information between the contracting parties. The BIT between Japan and Viet Nam (2003) is a case in point:

*“Article 7*

1. *Each Contracting Party shall promptly publish, or otherwise make publicly available, its laws, regulations, administrative procedures and administrative rulings and judicial decisions of general application as well as international agreements which pertain to or affect investment activities.*
2. ***Each Contracting Party shall, upon request by the other Contracting Party, promptly respond to specific questions and provide that other Contracting Party with information on matters set out in paragraph 1 above.***
3. *The provisions of paragraphs 1 and 2 of this Article shall not be construed so as to oblige either Contracting Party to disclose confidential information, the disclosure of which would impede law enforcement or otherwise be contrary to the public interest, or which would prejudice privacy or legitimate commercial interests.”* (emphasis added)

Other BITs combine the approaches explained before and address the issue of transparency in a more comprehensive way. The BIT between Cuba and Mexico (2001) illustrates this approach. Despite including obligations, which in most other BITs would fall under the heading of transparency, this agreement denominates the provision as *"investment promotion"*, recognizing the key role of transparency in fostering investment flows:

*“Article 3  
Investment Promotion*

1. *Each Party, with the intention to significantly increase flows of investments of investors of the other Party, may facilitate detailed information, both to the other Party and investors of the other Party, regarding:*
  - a) *investment opportunities in its territory;*
  - b) *national legislation which, directly or indirectly, affects foreign investment including, among others, exchange regimes and those of fiscal nature.*
2. *Each Party may provide to the other Party aggregated information on foreign investment in its country with respect to its origin, economic activities benefited, investment modalities and other which may be available.*
3. *Upon request of any investor of one Party who will make an investment in the territory of the other Party, the latter shall provide the information legally available to fully assess the legal situation of the assets comprised by the investment in question.”* (non-official translation from Spanish)

Most approaches regarding transparency in recent BITs are centred on the relationship between countries, and do not directly establish any obligation between the host country and the investor. However, some BITs — such as the one cited above — have started to deviate from this trend in various ways. These BITs include the investors in transparency regulations. They conceive transparency as extending beyond the traditional notion of publication of laws and regulations: they also focus on the process of rulemaking, attempting to use transparency as an instrument to promote the concept of due process and to allow interested stakeholders to participate in investment-related rulemaking. An example is the 2004 Canadian model BIT:

*“Article 19  
Transparency*

1. *Each Party shall, to the extent possible, ensure that its laws, regulations, procedures, and administrative rulings of general application respecting any matter covered by this Agreement are promptly published or otherwise made available in such a manner as to enable **interested persons** and the other Party to become acquainted with them.*
2. *To the extent possible, each Party shall:*
  - a) *publish in advance any such measure that it proposes to adopt; and*
  - b) *provide **interested persons** and the other Party a reasonable opportunity to comment on such proposed measures.*
3. *Upon request by a Party, information shall be exchanged on the measures of the other Party that may have an impact on covered investments.”* (emphasis added)

This approach applies transparency not only to existing legislation, but also to draft laws and regulations. In addition, all interested persons are to have an opportunity to comment on these proposals. Thus, the obligation is applicable not only in respect of investors of the other contracting party, but also between each contracting party and its own citizens. This method, which is also used in the BIT between the United States and Uruguay (2005) — see below — represents a qualitative leap as regards the content and rationale of transparency provisions in BITs.

The emphasis of some BITs on using transparency provisions to strengthen the concept of due process of law is underlined by some supplementary obligations included in other agreements. An example is the BIT between the United States and Uruguay (2005), which includes within the transparency provision explicit obligations on administrative procedures and the right to have an impartial review and appeal in respect of administrative decisions on investment-related matters.<sup>105</sup>

*“Article 11: Transparency*

1. *Contact Points*

- (a) *Each Party shall designate a contact point or points to facilitate communications between the Parties on any matter covered by this Treaty.*
- (b) *On the request of the other Party, the contact points shall identify the office or official responsible for the matter and assist, as necessary, in facilitating communication with the requesting Party.*

2. *Publication*

*To the extent possible, each Party shall:*

- (a) *publish in advance any measure referred to in Article 10(1)(a) that it proposes to adopt; and*
- (b) *provide interested persons and the other Party a reasonable opportunity to comment on such proposed measures.*

3. *Notification and Provision of Information*

- (a) *To the maximum extent possible, each Party shall notify the other Party of any proposed or actual measure that the Party considers might materially affect the operation of this Treaty or otherwise substantially affect the other Party’s interests under this Treaty.*
- (b) *On request of the other Party, a Party shall promptly provide information and respond to questions pertaining to any actual or proposed measure referred to in subparagraph (a), whether or not the other Party has been previously notified of that measure.*
- (c) *Any notification, request, or information under this paragraph shall be provided to the other Party through the relevant contact points.*
- (d) *Any notification or information provided under this paragraph shall be without prejudice as to whether the measure is consistent with this Treaty.*

4. *Administrative Proceedings*

*With a view to administering in a consistent, impartial, and reasonable manner all measures referred to in Article 10(1)(a), each Party shall ensure that in its administrative proceedings applying such measures to particular covered investments or investors of the other Party in specific cases that:*

- (a) *wherever possible, persons of the other Party that are directly affected by a proceeding are provided reasonable notice, in accordance with domestic procedures, when a proceeding is initiated, including a description of the nature of the proceeding, a statement of the legal authority under which the proceeding is initiated, and a general description of any issues in controversy;*
- (b) *such persons are afforded a reasonable opportunity to present facts and arguments in support of their positions prior to any final administrative action, when time, the nature of the proceeding, and the public interest permit; and*
- (c) *its procedures are in accordance with domestic law.*

5. *Review and Appeal*

- (a) *Each Party shall establish or maintain judicial, quasi-judicial, or administrative tribunals or procedures for the purpose of the prompt review and, where warranted, correction of final administrative actions regarding matters covered by this Treaty. Such tribunals shall be impartial and independent of the office or authority entrusted with administrative enforcement and shall not have any substantial interest in the outcome of the matter.*
- (b) *Each Party shall ensure that, in any such tribunals or procedures, the parties to the proceeding are provided with the right to:*
  - (i) *a reasonable opportunity to support or defend their respective positions; and*
  - (ii) *a decision based on the evidence and submissions of record or, where required by domestic law, the record compiled by the administrative authority.*
- (c) *Each Party shall ensure, subject to appeal or further review as provided in its domestic law, that such decisions shall be implemented by, and shall govern the practice of, the offices or authorities responsible for the administrative action at issue.”*

Although not specifically aimed at addressing the issue of transparency, some BITs do include a generic clause on consultations and exchange of views among the contracting parties, which could be used for the same purpose. The BIT between the Netherlands and Panama (2000) illustrates this approach:

*“Article 11  
Consultations*

*Either Contracting Party may propose to the other Contracting Party that consultations be held on any matter concerning the interpretation or application of the present Agreement. The other Contracting Party shall accord sympathetic consideration to the proposal and shall afford adequate opportunity for such consultations.”*

\* \* \*

In conclusion, only a small — albeit growing — minority of BITs of the last decade include provisions on transparency. However, to the extent that BITs deal with this issue, there have been significant developments concerning the content of the clause. Transparency is no longer exclusively perceived as a matter of the contracting parties exchanging investment-related information. In addition, a few recent BITs grant information rights to all "interested persons" and even allow them to comment on draft legislation. Some BITs also enhance investor rights in administrative and judicial proceedings and provide for third-party participation.

## **K. Treaty exceptions and emerging issues**

### **1. General treaty exceptions**

The rationale for a general exception is to exempt a contracting party from the obligations of the BIT in situations in which compliance would be incompatible with key policy objectives explicitly identified in the agreement. Most often, for a general exception to be permitted, the otherwise non-consistent measure by the contracting party must be taken on a non-discriminatory basis. Some such measures are allowed only temporarily.

In this sense, a general exception is a mechanism enabling the contracting parties to strike a balance between investment protection, on the one hand, and the safeguarding of other values considered to be fundamental by the countries concerned, on the other hand. Such values include, for example, public health, safety, national security and environmental protection. General exceptions ensure that the BIT obligations do not prevent the country concerned from applying its domestic legislation in order to safeguard any of these fundamental values.

In general, it appears that a conflict between these two kinds of objectives would be rare. Even after concluding a BIT, a contracting party may still apply its domestic legislation to pursue a wide range of policy objectives. As most BITs apply only to investments established in the host country in accordance with the latter's laws and regulations, contracting parties have significant leeway to control and restrict the establishment of foreign investment. In addition, insofar as measures are non-discriminatory and respect the other obligations in the BIT, contracting parties retain the right to adopt and implement national policies.

Some BITs under review clarify this point, as demonstrated by the BIT between Mauritius and Singapore (2000):

*“Article 10  
Laws*

*For the avoidance of any doubt, it is declared that all investments shall, subject to this Agreement, be governed by the laws in force in the territory of the Contracting Party in which such investments are made.”*

During the review period, the number of BITs including general treaty exceptions has increased. One might think that this trend would be more evident in those BITs providing for a right of establishment, since in these cases the host country has less leeway to screen the admission of the investment. However, the survey of BITs does not confirm the existence of a co-relation between frequency in the use of general treaty exceptions and inclusion of an admission clause in the agreements.

General exception clauses can safeguard a wide variety of policy objectives. Broadly speaking, general treaty exceptions in BITs of the last 10 years can be divided into the following categories: taxation; essential security and public order; protection of human health and natural resources; protection of culture; prudential measures for financial services; and miscellaneous.

**a. Taxation**

Taxation policy is a sensitive issue in most countries, and is handled by authorities that are different from those negotiating investment agreements. Countries not only want to prevent any conflict of competence among their different government agencies, but also are keen to prevent BITs from limiting their right to pursue fiscal policies (UNCTAD 2000c).

Several more recent BITs include a general exception on taxation. However, the approaches used to safeguard flexibility for implementing fiscal policies are not always the same.

One type of general exception excludes all taxation matters from the scope of application of the agreement. The BIT between Argentina and New Zealand (1999) is an example:

*“Article 5  
Exceptions*

[...]

(2) *The provisions of this Agreement shall not apply to matters of taxation in the territory of either Contracting Party. Such matters shall be governed by the domestic laws of each Contracting Party and the terms of any agreement relating to taxation concluded between the Contracting Parties [...]*<sup>106</sup>

Thus, no taxation law or regulation, regardless of its degree of inconsistency with any of the treaty obligations, could be successfully challenged under the BIT.

Another kind of general exception excludes, in principle, all tax matters from the scope of application of the BIT, and yet leaves the possibility of applying the treaty in certain specific situations. Within this category, some exceptions on taxation are more complex than others. Some provide for only a couple of situations in which the BIT would cover taxation matters. Other exceptions not only apply to more situations, but also specify certain conditions that would need to be met for such purpose. One can distinguish different variations, as exemplified by BITs of Canada and Japan.

The Canadian model BIT (2004) embodies the first approach:

“Article 16  
Taxation Measures

1. *Except as set out in this Article, nothing in this Agreement shall apply to taxation measures. For further certainty, nothing in this Agreement shall affect the rights and obligations of the Parties under any tax convention. In the event of any inconsistency between the provisions of this Agreement and any such convention, the provisions of that convention shall apply to the extent of the inconsistency.*
2. *Nothing in this Agreement shall be construed to require a Party to furnish or allow access to information the disclosure of which would be contrary to the Party’s law protecting information concerning the taxation affairs of a taxpayer.*
3. *A claim by an investor that a tax measure of a Party is in breach of an agreement between the central government authorities of a Party and the investor concerning an investment shall be considered a claim for breach of this Agreement unless the taxation authorities of the Parties, no later than six months after being notified by the investor of its intention to submit the claim to arbitration, jointly determine that the measure does not contravene such agreement. The investor shall refer the issue of whether a taxation measure does not contravene an agreement for a determination to the taxation authorities of the Parties at the same time that it gives notice under Article 24 (Notice of Intent to Submit a Claim to Arbitration).*
4. *The provisions of Article 13 shall apply to taxation measures unless the taxation authorities of the Parties, no later than six months after being notified by an investor that the investor disputes a taxation measure, jointly determine that the measure in question is not an expropriation. The investor shall refer the issue of whether a taxation measure is an expropriation for a determination to the taxation authorities of the Parties at the same time that it gives notice under Article 24 (Notice of Intent to Submit a Claim to Arbitration).*
5. *An investor may submit a claim relating to taxation measures covered by this Agreement to arbitration under Section C only if the taxation authorities of the Parties fail to reach the joint determinations specified in paragraph 3 and paragraph 4 of this Article within six months of being notified in accordance with the provisions of this Article.*
6. *If, in connection with a claim by an investor of a Party or a dispute between the Parties, an issue arises as to whether a measure of a Party is a taxation measure, a Party may refer the issue to the taxation authorities of the Parties. The taxation authorities shall decide the issue, and their decision shall bind any Tribunal formed pursuant to Section C or arbitral panel formed pursuant to Section D, as the case may be, with jurisdiction over the claim or the dispute. A Tribunal or arbitral panel seized of a claim or a dispute in which the issue arises may not proceed pending receipt of the decision of the taxation authorities. If the taxation authorities have not decided the issue within six months of the referral, the Tribunal or arbitral panel shall decide the issue in place of the taxation authorities.*
7. *The taxation authorities referred to in this Article shall be the following until notice in writing to the contrary is provided to the other Party:*
  - (a) *for Canada: the Assistant Deputy Minister, Tax Policy, of the Department of Finance Canada;*
  - (b) *for \_\_\_\_\_:”*

This clause attempts to strike a balance between the protection that the BIT and an investment contract may provide to a foreign investor, on the one hand, and the concern of the government authorities to safeguard flexibility to implement their fiscal policies, on the other hand. The exception sets up a mechanism through which the competent authorities of each contracting party may override an investor’s claim that a taxation measure violates the BIT or an agreement negotiated between the investor and the central authorities of a contracting party. In other words, the BIT does not, in principle, apply to taxation measures, unless the competent authorities of each contracting party disagree among themselves that they amount in fact to an expropriation or that such measures violate a contract previously agreed between the investor and the host country.

A second variation of a general exception on taxation is included in recent treaties of Japan. For instance, the BIT between Japan and Viet Nam (2003) states the following:



*“Article 19*

1. *Nothing in this Agreement shall apply to taxation measures except as expressly provided for in paragraphs 2, 3 and 4 of this Article.*
2. *Articles 1, 3, 7, 9, 22, and 23, shall apply to taxation measures.*<sup>107</sup>
3. *Articles 13, and 14, shall apply to disputes under paragraph 2 above.*<sup>108</sup>
4. *Article 20, shall apply to taxation measures regarding matters set out in paragraph 2 of this Article.*<sup>109</sup>

There are several similarities between this concept and the tax exception used in the Canadian model BIT. However, the Japanese approach contains two important differences. First, more obligations of the BIT apply to taxation measures, and second, the investors do not depend on any decision of the contracting parties to be able to submit a claim.

In contrast to the above examples, there are also some BITs that apply, in principle, to taxation matters. However, they include a limited exception concerning the obligation not to discriminate. These treaties allow a contracting party to abstain from granting national treatment and MFN treatment to investors of the other contracting party with respect to any tax benefit that the former may grant to its citizens or residents. The protocol of the BIT between Germany and Mexico (1998) typifies this approach:

*“Protocol*

[...]

3. *Ad article 3*

[...]

(b) *The provisions in Article 3 [National Treatment and MFN Treatment] are not binding for a Contracting State to extend to the natural persons and companies resident in the other Contracting State’s territory: the tax benefits, exemptions and reductions which according to tax laws are applicable only to natural persons and residents in the Contracting State’s territory.”*

If a contracting party adopted taxation measures inconsistent with any of the obligations of the agreement other than those on national treatment and MFN treatment, they could, in principle, be challenged under the dispute settlement procedures in the BIT. An example is excessive taxation amounting to indirect expropriation (“confiscatory tax measure”).

## **b. Essential security and public order**

A second category of exceptions in several BITs comprises those safeguarding the flexibility of the contracting parties to take any kind of measure that is considered necessary to protect their essential security interests and maintain public order. These exceptions can be analysed from two different perspectives. One is to focus on the clarification of the policy objectives that these exceptions purport to protect. The other is to observe the architecture and scope of the exceptions.

Regarding the first angle, BITs avoid including a definition of what should be understood as *essential security* or *public order*. By leaving these terms undefined contracting parties may wish to safeguard their flexibility to determine on their own, on a case-by-case basis, whether they are facing a situation in which their essential security or public order is threatened. One pertinent question in this respect is, for example, whether measures of a contracting party in response to economic crisis might be covered by an *essential security* exception. It appears that there does not yet exist any jurisprudence on this specific issue.

The context in which the terms *essential security* and *public order* are used in most BITs suggests that they refer to different situations. Some BITs explicitly differentiate between the two concepts. For instance, the BIT between Finland and Kyrgyzstan (2003) states the following:

“Article 14  
General derogations

1. *Nothing in this Agreement shall be construed as preventing a Contracting Party from taking any action necessary for the protection of its **essential security interests** in time of war or armed conflict, or other emergency in international relations.*
2. *Provided that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination by a Contracting Party, or a disguised investment restriction, nothing in this Agreement shall be construed as preventing the Contracting Parties from taking any measure necessary for the maintenance of **public order**. [...]* (emphasis added)

Other BITs provide some guidance for differentiating an exception on *national security* grounds from one on *public order* grounds. This is the case of the BIT between Japan and the Republic of Korea (2002):

“Article 16

1. *Notwithstanding any other provisions in this Agreement other than the provisions of Article 11, each Contracting Party may:*
  - (a) *take any measure which it considers necessary for the protection of its **essential security interests**;*
    - (i) *taken in time of war, or armed conflict, or other emergency in that Contracting Party or in international relations; or*
    - (ii) *relating to the implementation of national policies or international agreements respecting the non-proliferation of weapons;*
  - (b) *take any measure in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security;*
  - (c) *[...] or*
  - (d) *take any measure necessary for the maintenance of **public order**. The public order exceptions may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society. [...]* (emphasis added)

The protection of essential security interests mainly applies in situations where the country wants to protect itself against international or domestic situations of war, armed conflict or any other kind of belligerence or international emergency. By contrast, the maintenance of public order refers to ensuring peace and the rule of law within the country in situations below the threshold of a threat to national security.

The specific terminology in the drafting of clauses addressing these topics varies among BITs. Instead of the term "*essential security interests*", other BITs, such as the agreement between Hong Kong (China) and New Zealand (1995), use the term "*essential interests*", while some treaties refer to "*national security interests*", as is the case of the BIT between CARICOM and Cuba (1997) (table 22).

Some exceptions refer to other related policy objectives to justify the non-application of the obligations in the BIT. These exceptions relate to *circumstances of extreme emergency* and the necessity to comply with *obligations with respect to maintenance and restoration of international peace and security*.

An example of a reference to situations of "*extreme emergency*" is the BIT between Croatia and India (2001):

“Article 12  
Applicable Laws

- (1) *Except as otherwise provided in this Agreement, all investments shall be governed by the laws in force in the territory of the Contracting Party in which such investments are made.*
- (2) *Notwithstanding paragraph 1 of this Article nothing in this Agreement precludes the host Contracting Party from taking action for the protection of its essential security interests or in **circumstances of extreme emergency**, provided such actions have been prescribed by its laws*

*which are applied normally and reasonably, on a non discriminatory and a non arbitrary basis.” (emphasis added)*

**Table 22. Examples of provisions on essential security exceptions**

BIT between Australia and India (1999)	BIT between Hong Kong (China) and New Zealand (1995)	BIT between CARICOM and Cuba (1997)
<p style="text-align: center;">“Article 15 Prohibitions and restrictions</p> <p>Nothing in this Agreement precludes the host Contracting Party from taking, in accordance with its laws applied reasonably and on a non-discriminatory basis, measures necessary for the protection of its own <b>essential security interests</b> or for the prevention of diseases or pests.” (emphasis added)</p>	<p style="text-align: center;">“Article 8 Exceptions</p> <p>[...] 3. The provisions of this Agreement shall not in any way limit the right of either Contracting Party to take measures directed to the protection of its <b>essential interests</b> ... provided that such measures are not applied in a manner which would constitute a means of arbitrary or unjustified discrimination.” (emphasis added)</p>	<p style="text-align: center;">“Article XVII General exemptions</p> <p>[...] 2. This Agreement shall not preclude the application by either Party of measures necessary for the protection of its own <b>national security interests.</b>” (emphasis added)</p>

Once again, this mode does not define what should be understood as “*circumstances of extreme emergency*”, leaving the concept to be clarified on a case-by-case basis.

In addition to the protection of essential security interests, several BITs provide for the right of a contracting party to invoke a general treaty exception in situations where compliance with the agreement would impede “*the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security*”. This type of exception is included in practically all BITs of the United States, and, more recently, in the 2004 Canadian model BIT. An illustration of this manner is the BIT between Mozambique and the United States (1998).

*“Article XVI*

1. *This Treaty shall not preclude a Party from applying measures that it considers necessary for the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests. [...]*

This clause provides the contracting parties with discretion to determine whether a particular measure is in fact necessary in order to comply with obligations concerning the maintenance or restoration of international peace or security, or to protect a contracting party's essential security interests. Such a "self-judging" provision has important legal consequences, since it would impede a neutral body — such as an international arbitration tribunal — from making its own independent assessment of whether the measure taken by the host country authorities was actually necessary or not. Furthermore, the provision does not specify the origin of such obligations. In this regard, the clause contrasts with the 2004 Canadian model BIT, which explicitly states that such obligations would be those derived from the Charter of the United Nations:

*“Article 10  
General Exceptions*

[...]

4. *Nothing in this Agreement shall be construed:*

[...]

- (c) *to prevent any Party from taking action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.”*

Another way to look at the essential security exceptions is to observe the different approaches used in BITs regarding their architecture and scope. From this perspective, the agreements under review have applied a number of techniques.

Rather than exempting a contracting party from complying with the BIT in situations of protection of essential security interests, one category of agreements exempts the country concerned only from the obligations of national treatment and MFN treatment. The protocol of the BIT between Germany and Mexico (1998) is an example:

*“Protocol*

[...]

3. *Ad article 3*

(a) *The measures taken by reason of national security, public interest, public health or morality shall not be considered as a “less favourable treatment”, according to Article 3.*

[...]”<sup>110</sup>

A second means is to oblige the contracting party invoking the essential security exception to comply with certain procedural requirements vis-à-vis the other contracting party. The BIT between Japan and Viet Nam (2003) characterizes this method:

*“Article 15*

1. *Notwithstanding any other provisions in this Agreement other than the provisions of Article 10,<sup>111</sup> each Contracting Party may:*

(a) *take any measure which it considers necessary for the protection of its essential security interests [...]*

(b) *take any measure in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security;*

[...] *or*

(d) *take any measure necessary for the maintenance of public order. The public order exceptions may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.*

2. *In cases where a Contracting Party takes any measure, pursuant to paragraph 1 above, that does not conform with the obligations of the provisions of this Agreement other than the provisions of Article 10, that Contracting Party shall not use such measure as a means of avoiding its obligations.*

3. *In cases where a Contracting Party takes any measure, pursuant to paragraph 1 of this Article, that does not conform with the obligations of the provisions of this Agreement other than the provisions of Article 10, that Contracting Party shall, prior to the entry into force of the measure or as soon thereafter as possible, notify the other Contracting Party of the following elements of the measure: (a) sector and sub-sector or matter; (b) obligation or article in respect of the measure; (c) legal source of the measure; (d) succinct description of the measure; and (e) purpose of the measure.”*

A third method is to refrain from including an explicit provision in the treaty, and instead to prevent covered investors from invoking the dispute settlement rules of the agreement. The BIT between Mexico and Sweden (2000) epitomizes this approach.

*“Article 18*

*Exclusions*

*The dispute settlement provisions of this Section shall not apply to the resolutions adopted by a Contracting Party which, in accordance with its legislation, and for national security reasons, prohibit or restrict the acquisition by investors of the other Contracting Party of an investment in the territory of the former Contracting Party, owned or controlled by its nationals.”*

A fourth method allows contracting parties to invoke their national laws, including those on essential security grounds, and make this right subject to the obligations of the agreement. For instance, the BIT between Ghana and India (2002) states:

*“Article 12  
Applicable Laws*

*(1) Except as otherwise provided in this Agreement, all investments shall be governed by the laws in force in the territory of the Contracting Party in which such investments are made including such laws enacted for the protection of its essential security interests or in circumstances of extreme emergency provided however that such laws are reasonably applied on a non-discriminatory basis.”*  
(emphasis added)

On the one hand, the wording of this clause suggests that the original intention of the contracting parties was to allow themselves total flexibility in protecting their essential security interests. On the other hand, the text states that the laws in force in the territory of the contracting parties shall govern the investments “*except as otherwise provided in this Agreement*”. As most of the core obligations in the BIT cited above are not subordinated to domestic legislation, it appears that the contracting parties are prevented from invoking national laws to refrain from complying with these obligations.

### c. Protection of health and natural resources

A third category of exceptions in some recent BITs allows the contracting parties to adopt or maintain a measure inconsistent with the obligations of the agreement, provided that such measure is necessary for ensuring the protection of human, animal or plant life or health or, in some cases, the protection of natural resources. General treaty exceptions for the protection of health, life and natural resources are less frequent than exceptions protecting other policy objectives, such as taxation and essential security interests.

Once again, the specific terminology used in the different exceptions varies from one treaty to another. However, unlike in the case of an essential security exception — the scope of which depends on the interpretation of an undetermined concept subject to the eye of the beholder — the determination of whether a particular measure is *necessary* for the protection of health or natural resources entails a more objective and precise assessment.

BITs concluded since 1996 follow different approaches to drafting this specific kind of exception. A method used in several agreements consists in simply allowing the contracting party to invoke the exception, provided that the inconsistent measure is necessary, and that it serves the purpose of protecting the policy objectives it claims to safeguard. An example is the BIT between Mauritius and Switzerland (1998):

*“Article 11  
Other Rules and Specific Commitments*

[...]  
*(3) Nothing in this Agreement shall be construed to prevent a Contracting Party from taking any action necessary [...] for reasons of public health or the prevention of diseases in animals and plants.”*

Another method in some BITs is to make the exception conditional on the fulfilment of certain requirements aimed at preventing its abuse. This method obliges the contracting party to apply the otherwise non-consistent measure on a non-discriminatory basis and to avoid using it as a disguised restriction on investment. Thus, the contracting party invoking the exception has to demonstrate the necessity of the non-consistent measure. In addition, the contracting party would need to show not only that the particular measure is applied on a non-discriminatory basis, but also that it is the less distortional in safeguarding the policy objectives. Different variations of this approach exist (table 23).

Table 23. Examples of exceptions to protect health and natural resources

BIT between Argentina and New Zealand (1999)	BIT between Australia and India (1999)	BIT between Armenia and Canada (1997)
<p style="text-align: center;">“Article 5 Exceptions</p> <p>[...] (3) The provisions of this Agreement shall in no way limit the right of either Contracting Party to take any measures (including the destruction of plants and animals, confiscation of property or the imposition of restrictions on stock movement) necessary for the protection of natural and physical resources or human health, <b>provided such measures are not applied in a manner which would constitute a means of arbitrary or unjustified discrimination.</b>” (emphasis added)</p>	<p style="text-align: center;">“Article 15 Prohibitions and restrictions</p> <p>Nothing in this Agreement precludes the host Contracting Party from taking, in accordance with its laws <b>applied reasonably and on a non-discriminatory basis</b>, measures necessary for [...] the prevention of diseases or pests.” (emphasis added)</p>	<p style="text-align: center;">“Article XVII: Application and General Exceptions</p> <p>[...] 3. Provided that such measures are <b>not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment</b>, nothing in this Agreement shall be construed to prevent a Contracting Party from adopting or maintaining measures, including environmental measures: (a) necessary to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; (b) necessary to protect human, animal or plant life or health; or (c) relating to the conservation of living or non-living exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption. [...]” (emphasis added)</p>

There is a third mode, which relates to the health and natural resources exception. Used in several BITs, it consists in obliging the contracting party invoking the exception to comply with certain procedural requirements vis-à-vis the other contracting party rather than simply allowing the former to grant itself a waiver from the obligations of the BIT.

For instance, article 16.1 (c) of the BIT between Japan and the Republic of Korea (2002) provides that “[n]otwithstanding any other provisions in this Agreement other than the provisions of Article 11, each Contracting Party may [...] take any measure necessary to protect human, animal or plant life or health”.<sup>112</sup> Despite this authorization of the contracting parties to deviate from the obligations of the BIT, the exception explicitly conditions this right to the fulfilment of certain procedural requirements. Article 16 paragraphs 2 and 3 of this BIT mandate the contracting parties to refrain from using the exception as a means to avoid their obligations under the agreement.<sup>113</sup> Furthermore, the treaty stipulates that if a contracting party takes any non-consistent measure pursuant to the exception, it shall notify the other party of the measure prior to its entry into force or as soon as possible thereafter, as well as of its elements, legal basis and purpose.

The BIT between the United States and Uruguay (2005) embodies a fourth approach:

*“Article 12: Investment and Environment*

[...]

2. *Nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure **otherwise consistent with this Treaty** that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.*” (emphasis added)

Rather than constituting permission to disregard an obligation included in the treaty, this clause confirms the sovereign right of the contracting parties to take measures that they consider appropriate for the protection of the environment.<sup>114</sup> However, such measures are allowed only if they do not violate BIT obligations. The purpose of the clause is therefore mainly explanatory. It is a tool for sending a message to civil societies that the contracting parties take environmental concerns into account.

According to this view, there remains a risk of incompatibility between investment protection and the protection of health or natural resources. Such risk would exist with respect to expropriation if an investor challenges measures taken to protect health or the environment on the basis that they would constitute an indirect expropriation.<sup>115</sup> To address this situation, the BIT between the United States and Uruguay (2005) provides the following:

*“Annex B  
Expropriation*

*The Parties confirm their shared understanding that: [...]*

4. [...] (b) *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.”*

In sum, the above concept relies on the hypothesis that if contracting parties purport to protect health, safety or the environment rather than using those objectives as a disguised means to discriminate against foreign investment, the BIT should not limit the flexibility required in order to safeguard these key values of society.

#### **d. Cultural exceptions**

The increasing level of internationalisation generates tendencies in national societies towards cultural harmonization. It is within this context that some BITs under review have included cultural exceptions. They aim at safeguarding the discretion of the contracting parties to adopt measures considered necessary for preserving national culture or promoting cultural diversity.

The inclusion of a cultural exception in BITs has been practically limited to treaties of Canada and to some negotiated by France.<sup>116</sup> Although fundamentally pursuing the same ends, the approaches in designing this clause have been different.

The BIT between France and Uganda (2002) demonstrates one method used in these agreements:

*“Article 1  
Definitions*

[...]

6. *Nothing in this agreement shall be construed to prevent any contracting party from taking any measure to regulate investment of foreign companies and the conditions of activities of these companies in the framework of policies designed to preserve and promote cultural and linguistic diversity.”*<sup>117</sup>

This approach is relatively broad. It provides contracting parties with full discretion to adopt any kind of measure to regulate foreign investment, even after it has been admitted into the host country. The exception covers not only measures directly addressing cultural issues, but also those addressing related matters, such as the production or distribution of a manufacture or service, or the regulation of property rights. Insofar as those measures were taken within the framework of policies designed to preserve and promote cultural and linguistic diversity, they would be covered by the cultural exception.

Furthermore, it is the country invoking the exception that, in principle, determines whether a particular measure fits within the policy framework designed to preserve and promote cultural and linguistic

diversity. It would be difficult to second-guess such an assessment in an international arbitration case. In this regard, it should be noted that the exception does not require the measure to be *necessary* for the preservation and promotion of cultural and linguistic diversity. It would be sufficient that the measure was *designed* to pursue those ends.

The other concept is followed by Canada.<sup>118</sup> It focuses on investments in *cultural industries*, which are excluded from the scope of application of the agreement. The BIT between Canada and Thailand (1997) is an example:

“Article VI  
Miscellaneous Exceptions

[...]

3. *Investments in cultural industries are exempt from the provisions of this Agreement. “Cultural industries” means persons engaged in any of the following activities:*
- (a) the publication, distribution, or sale of books, magazines, periodicals or newspapers in print or machine readable form but not including the sole activity of printing or typesetting any of the foregoing;*
  - (b) the production, distribution, sale or exhibition of film or video recordings;*
  - (c) the production, distribution, sale or exhibition of audio or video music recordings;*
  - (d) the publication, distribution, sale or exhibition of music in print or machine readable form;*  
*or*
  - (e) radio communications in which the transmissions are intended for direct reception by the general public, and all radio, television or cable broadcasting undertakings and all satellite programming and broadcast network services.”*

Technically speaking, this approach is not an exception, but rather an exclusion of a sector from the scope of application of the agreement.

Another noteworthy aspect is the use of an exhaustive list of cultural industries. It enables investors to identify the scope of the exclusion before the investment is made. As opposed to using a broad conceptual exception providing the countries with significant flexibility, this approach requires greater clarity on the part of the contracting parties as to the specific activities that they consider to be crucial for the protection of cultural values.

#### **e. Prudential measures for financial services**

A fifth category of exceptions included in some recent BITs enables contracting parties to adopt or maintain measures on financial services that are inconsistent with the obligations of the agreement, provided that such measures are justified for prudential reasons.

Financial services are usually heavily regulated and subject to close supervisory control by specialized governmental authorities. This reflects the fact that financial services represent a sector that is not only important in its own right, but also has a crucial impact on other sectors of the economy. Thus, some countries consider it important to explicitly ensure that their supervisory authorities have enough discretion to implement the relevant regulations.

Not many BITs under review include prudential exceptions applicable to financial services. At the beginning of the period, this practice was almost exclusively limited to Canadian BITs and some Caribbean countries. However, more recently, an increasing number of agreements have followed suit. This is the case of several BITs of Japan and the United States.

BITs specifically dealing with financial services usually make reference to different kinds of prudential measures. The first category comprises measures aimed at the protection of the clients of financial institutions, such as investors, depositors or financial market participants. A second group of BITs applies to financial institutions to ensure their safety, soundness, integrity or financial responsibility. Other agreements



refer to those laws and regulations that aim at safeguarding the integrity and stability of the financial system as a whole.

Unlike in the case of other investment-related issues, the level of convergence concerning prudential exceptions for financial services is remarkable. Despite some minor variations of language, the exceptions in the different BITs contain the same basic elements. Contracting parties are authorized to adopt or maintain laws or regulations of a prudential nature with respect to financial services. The clauses also include some specific examples of the kind of measures covered by the exception. Another element often included in this kind of exception is the commitment of contracting parties to abstain from applying a prudential measure as a means of disregarding the obligations assumed under the applicable BIT (table 24).

**Table 24. Examples of exceptions on prudential measures in financial services**

BIT between the United States and Uruguay (2005)	BIT between Japan and Viet Nam (2003)	Canadian model BIT (2004)
<p>“Article 20: Financial Services</p> <p>1. Notwithstanding any other provision of this Treaty, a Party shall not be prevented from adopting or maintaining measures relating to financial services for prudential reasons, including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial services supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of this Treaty, they shall not be used as a means of avoiding the Party’s commitments or obligations under this Treaty.</p> <p>2. (a) Nothing in this Treaty applies to non-discriminatory measures of general application taken by any public entity in pursuit of monetary and related credit policies or exchange rate policies. This paragraph shall not affect a Party’s obligations under Article 7 or Article 8.</p> <p>(b) For purposes of this provision, “public entity” means a central bank or monetary authority of a Party. [...]”</p>	<p>“Article 17</p> <p>1. Notwithstanding any other provisions of this Agreement, a Contracting Party may adopt or maintain prudential measures with respect to financial services, including measures for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by an enterprise providing financial services, or to ensure the integrity and stability of its financial system.</p> <p>2. In cases where a Contracting Party takes any measure, pursuant to paragraph 1 above, that does not conform with the obligations of the provisions of this Agreement, that Contracting Party shall not use such measure as a means of avoiding its obligations. [...]”</p>	<p>“Article 10 General Exceptions</p> <p>[...]</p> <p>2. Nothing in this Agreement shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons, such as:</p> <p>(a) the protection of investors, depositors, financial market participants, policy-holders, policy-claimants, or persons to whom a fiduciary duty is owed by a financial institution;</p> <p>(b) the maintenance of the safety, soundness, integrity or financial responsibility of financial institutions; and</p> <p>(c) ensuring the integrity and stability of a Party's financial system.</p> <p>3. Nothing in this Agreement shall apply to non-discriminatory measures of general application taken by any public entity in pursuit of monetary and related credit policies or exchange rate policies. This paragraph shall not affect a Party’s obligations under Article 7 (Performance Requirements) or Article 14 (Transfer of Funds); [...]”</p>

#### f. Miscellaneous exceptions

In addition to the five subject-specific categories of exceptions previously explained, some recent BITs include general exceptions to address other concerns. For instance, some agreements use exceptions to exclude a certain geographical area from the application of the agreements.<sup>119</sup> Other BITs contain exception clauses to clarify the relationship between the treaty and agreements on intellectual property rights.<sup>120</sup>

Thus, general exceptions can serve multiple purposes. They are instruments to adjust the BIT models used by numerous countries to the particularities of the specific negotiation. Despite the significant degree of commonality between most BITs, the negotiation of each agreement has its own dynamics. Exception clauses can play a key role in establishing the necessary flexibility for contracting parties in order to obtain

the necessary political support in each capital. Furthermore, the multiplicity of issues addressed through miscellaneous exceptions evidences a trend that is often overlooked.

#### g. MFN exceptions

As explained in section E above, most BITs contain an MFN exception exempting contracting parties from granting investors of the other contracting party preferential treatment that they may provide to investors of third countries pursuant to regional economic integration or double taxation agreements. With some variations, this trend has continued among the majority of BITs under review. However, some agreements have converted this limited reservation into a *general* treaty exception, exempting the contracting parties not only from the MFN obligation, but also from any other obligation included in the treaty. The BIT between Finland and Mexico (1999) exemplifies this approach:

*“Article 4  
Exceptions*

*The provisions of this Agreement shall not be construed so as to oblige one Contracting Party to extend to the investors of the other Contracting Party the benefit of any treatment, preference or privilege by virtue of:*

- (a) any existing or future free trade area, customs union, common market or regional labour market agreement to which one of the Contracting Parties is or may become a party,*
- (b) any international agreement or arrangement relating wholly or mainly to taxation,*
- (c) any multilateral agreement on investments.”*

## 2. Emerging issues

As mentioned at the beginning of this section, there has been a significant trend in several recent BITs towards providing that investment promotion and protection must not be pursued at the expense of certain other key policy objectives. For this purpose, some BITs have included general exceptions, while other agreements have reiterated the authority of national Governments to design and implement measures to safeguard certain values, such as the protection of health, safety, the environment, and the promotion of internationally recognized labour rights.

The method for including positive language in BITs to reinforce the intention and prerogatives of the contracting parties to protect key societal values does not have the same legal effects as a general treaty exception. The result of the latter is to allow national authorities to disregard any obligation in the BIT on the basis that doing so is required in order to protect one of the policy objectives specified in the exception clause. The effect of including positive language, however, does not allow for exemption from BIT obligations.

One way of introducing positive language into the BIT is to reiterate the notion that there should be no conflict between the obligations in the agreement and the sovereign right of countries to pursue other key policy objectives. This constitutes a political statement by the contracting parties — a message usually included in the preambles of BITs, which may be used for the interpretation of the substantive provisions of the agreement.<sup>121</sup>

An alternative is a commitment by the contracting parties to abstain from lowering standards of protection in certain policy areas as a means of attracting foreign investment. This approach not only represents per se a strong political statement, but also may go further by converting the protection of the identified policy objectives into another binding obligation or a “best efforts” commitment. Thus, respect for these policy objectives becomes part of the context in which the rest of the obligations in the BIT have to be interpreted, and this significantly reduces the risk of a legal conflict between the two.

BITs have continued to be seen by contracting parties as *investment* agreements, and, as such, focus on the promotion and protection of investment. However, over the last 10 years, a limited number of BITs

has started to stress the safeguarding of certain other policy objectives. The protection of health, safety, the environment and core labour standards have gradually, but consistently, emerged as new issues in several BITs.

#### a. Protection of public health and safety

The protection of public health and safety is one of the issues that consistently appear among the BITs negotiated recently. Two different approaches can be distinguished. One approach is to underline the importance of adequately protecting this policy objective in the preambles of the treaties. The BIT between Namibia and the Netherlands (2002) typifies this trend:

*“Preamble*

*The Kingdom of the Netherlands and the Republic of Namibia, hereinafter referred to as the Contracting Parties,*

*[...]*

*Considering that a stable framework for international investment will promote effective utilization of economic resources and improve living standards;*

*[...]*

*Considering that these objectives can be achieved without compromising **health, safety** [...] measures of general application;*

*Have agreed as follows:” (emphasis added)*

This stresses that investment protection should not be considered incompatible with the objective of adequately protecting health and safety. This political statement has increasingly been included in several preambles of recent BITs, regardless of the region where the contracting parties are located. For instance, the preamble of the BIT between the Republic of Korea and Trinidad and Tobago (2002) states that the promotion and protection of investment “[...] *can be achieved without relaxing health, safety [...] measures of general application*”, and the BIT between Finland and Kyrgyzstan (2003) states that the objectives of promotion of investment flows “[...] *can be achieved without relaxing health, safety [...] measures of general application.*”<sup>122</sup>

The other approach, used in some recent BITs, is to include a non-legally binding commitment by the contracting parties to abstain from relaxing the protection standards as a means of attracting or maintaining investment in their territories. The BIT between Mexico and Switzerland (1995) illustrates this method:

*“Protocol  
Ad Article 3*

*The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety [...] measures. Accordingly, neither Party should waive or otherwise derogate from, or offer to waive or derogate, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If either Party considers that the other Party has offered such an encouragement, it may request consultations. [...]*” (emphasis added)

This clause, which is very similar to those in other BITs, makes reference to domestic health and safety measures.<sup>123</sup> Although this concept is not explicitly defined, it is implied that it applies to any law, regulation or administrative decision regulating health or safety in the territory of the contracting parties. It is not necessary to demonstrate a continuous pattern of behaviour for a contracting party to infringe the clause. Rather, it would suffice that a health or safety regulation was relaxed in favour of a single investor. Finally, the provision deals with the case of non-compliance by one party. In this situation, the other party may request consultations. The provision does not indicate, however, what would happen if those consultations failed.

## b. Protection of the environment

Of all the newly emerging issues, the BITs under review most frequently address the topic of environmental protection (UNCTAD, 2001b).

There are BITs that address the importance of protecting the environment in their preambles. They not only have very similar wording, but also stress the idea of compatibility between investment protection and environmental protection. An example is the preamble of the BIT between Mozambique and the Netherlands (2001):

*“The Government of the Republic of Mozambique and the Government of the Kingdom of the Netherlands (hereinafter the “Contracting Parties”);*

[...]

*Agreeing that a stable framework for international investment will maximise effective utilisation of economic resources and improve living standards;*

[...]

***Agreeing that these objectives can be achieved without relaxing health, safety and environmental measures of general application;***

[...]

*Have agreed as follows: [...]” (emphasis added)*

BITs addressing the importance of environmental protection in their preambles do not in general include any specific clause on this subject in the body of the agreement.<sup>124</sup> This is the case, for instance, of the BITs between Japan and Viet Nam (2003), between Namibia and the Netherlands (2002) and between Bosnia Herzegovina and Finland (2000). On the other hand, most BITs that include specific clauses on environmental protection do not make any reference to it in their preambles. Examples are the recent BITs of Belgium–Luxembourg with Botswana (2003), Ethiopia (2003), Mauritius (2005) and Zimbabwe (2003), and the Canadian model BIT (2004).

Other BITs deal with the issue of environmental protection in the main body of the agreement. For instance, numerous BITs have provisions that are subject to domestic legislation. This includes laws and regulations protecting the environment. The BIT between Costa Rica and the Netherlands (1999) is illustrative of this approach:

### *“Article 10*

*The provisions of this Agreement shall, from the date of entry into force thereof, apply to all investments made, whether before or after its entry into force, by investors of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter Contracting Party, **including its laws and regulations on labour and environment.***

*The provisions of this Agreement shall not apply to any dispute concerning an investment which arose, or any claim which was settled before its entry into force.” (emphasis added)*

This approach has the same legal effect as an admission clause. If the latter provides that the BIT shall apply only to those investments admitted into the host country in accordance with the host country's domestic legislation, it is evident that such laws and regulations include rules related to environmental protection. Thus, this approach is particularly useful for political purposes, since it signals to civil society and the international community that the contracting parties take environmental concerns into consideration when admitting foreign investment.

A third mode is, once again, a non-legally binding commitment by the contracting parties authorities to abstain from relaxing domestic standards as a means of attracting or maintaining investment in their territories. This idea has several variations, one of which is illustrated by the new Canadian model BIT (2004), which provides as follows:

*“Article 11  
Health, Safety and Environmental Measures*

*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, or offer to 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. If a Party considers that the other Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.”* (emphasis added)

The provision refers to “*environmental measures*” without defining them. It seems that this term would cover any law, regulation or administrative decision regulating environmental matters in the territory of the contracting parties. The clause addresses the waiving or relaxing of *any* environmental measure — or offering to do so — in order to attract or maintain an investment. In this connection, it would once again not be necessary to demonstrate a continuous pattern of behaviour by a contracting party in violation of the commitment. Rather, it would suffice that an environmental regulation was relaxed in favour of a single investor. Finally, the article stipulates that the parties will consult each other in situations in which one of them considers that the commitment has not been respected. However, it remains open as to what would happen if these consultations failed.

Several recent BITs of Belgium and Luxembourg show a variation of this approach,<sup>125</sup> an example of which is the BIT between Belgium–Luxembourg and Zimbabwe (2003):

*“Article 5  
Environment*

1. *Recognising the right of each Contracting Party to establish its own levels of domestic environmental protection and environmental development policies and priorities, and to adopt or modify accordingly its environmental legislation, each Contracting Party shall strive to ensure that its legislation provides for high levels of environmental protection and shall strive to continue to improve this legislation.*
2. *The Contracting Parties recognise that it is inappropriate to encourage investment by relaxing **domestic environmental legislation**. Accordingly, each Contracting Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, **such legislation** as an encouragement for the establishment, maintenance or expansion in its territory of an investment.*
3. *The Contracting Parties reaffirm their commitments under the international environmental agreements, which they have accepted. They shall strive to ensure that such commitments are fully recognised and implemented by their **domestic legislation**.*
4. *The Contracting Parties recognise that co-operation between them provides enhanced opportunities to improve environmental protection standards. Upon request by either Contracting Party, the other Contracting Party shall accept to hold expert consultations on any matter falling under the purpose of this Article.”* (emphasis added)

This provision is complemented by a definition of the term “*environmental legislation*”. It reads as follows:

*“Article 1  
Definitions*

*For the purpose of this Agreement,*

[...]

6. *The term "environmental legislation" shall mean any legislation of the Contracting Parties, or provision thereof, the primary purpose of which is the protection of the environment, or the prevention of a danger to human, animal, or plant life or health, through:*

- a) *the prevention, abatement or control of the release, discharge, or emission of pollutants or environmental contaminants;*
- b) *the control of environmentally hazardous or toxic chemicals, substances, materials and wastes, and the dissemination of information related thereto;*
- c) *the protection or conservation of wild flora or fauna, including endangered species, their habitat, and specially protected natural areas in the Contracting Party's territory."*

Unlike the Canadian model BIT previously referred to, this non-lowering of environmental standards clause refers only to "*environmental legislation*". It therefore has a narrower scope. Furthermore, it explicitly refers to the duty of each party to comply with the obligations that it has assumed under international environmental agreements. Another innovation is the explicit recognition that contracting parties may achieve better results in their efforts to improve environmental protection through international cooperation than through punitive means.

The Agreement between Belgium–Luxembourg and Zimbabwe (2003) does not explicitly exclude the right of a contracting party or a covered investor to submit a claim under the dispute settlement procedures of the BIT in order to enforce the commitments in article 5. It could be argued that by establishing a duty to accept consultations on any matter falling under this provision, the contracting parties expressed their intention to have a distinct mechanism to solve their differences in this particular area. However, it could also be argued that by not explicitly excluding dispute settlement article 5 is not different from any other BIT provision, the interpretation and application of which could be subject to those procedures.

The latter issue is explicitly dealt with in the BIT between the United States and Uruguay (2005). It states that the commitment on environmental protection is subject neither to the investor–State<sup>126</sup> nor to the State–State<sup>127</sup> dispute settlement procedures of the agreement. Furthermore, the BIT specifies in footnote 13 to article 12.1 that "*For the United States, "laws" for purposes of this Article means an act of the United States Congress or regulations promulgated pursuant to an act of the United States Congress that is enforceable by action of the central level of government*". This footnote indicates not only that administrative decisions are not included in the commitment of article 12.1, but also that laws enacted by State legislatures, at least in the case of the United States, are excluded from its scope.<sup>128</sup>

### **c. Protection of labour standards**

The third emerging issue in BIT negotiations is the protection of labour standards (UNCTAD 2001c). Unions in capital-exporting countries have raised concerns about BITs on the grounds that patterns of international production in general, and FDI in particular, would result in an increase in unemployment in their economies ("job exports"). It is argued that FDI inflows into developing countries would be partially generated by practices of "social dumping", as investors would prefer to locate in countries with lower labour protection standards.

As a result, capital-exporting countries have been confronted with pressure from their domestic constituencies to incorporate labour protection issues in the agenda of international investment negotiations. An increasing group of countries have therefore started to introduce this subject in investment rulemaking. However, at least among the BITs under review, the number of agreements addressing this issue is lower than the number of BITs dealing with environmental protection.

The techniques used to incorporate labour concerns in BITs have been basically the same as those for addressing other emerging issues. Most frequent is a political statement in the BIT preambles. Most agreements use similar language (table 25).

Another — rarely used — means of stressing the commitment of the contracting parties in favour of protecting labour standards is, once again, to provide that they shall strive to abstain from relaxing them as a means of attracting or maintaining investment in their territories. Examples are some agreements negotiated

during the last five years by Belgium and Luxembourg on the one hand, and the United States, on the other hand.<sup>129</sup>

**Table 25. Examples of references to international labour standards in preambles**

BIT between Finland and Nicaragua (2003)	BIT between Austria and Bosnia Herzegovina (2000)
<p>“The Government of the Republic of Finland and the Government of the Republic of Nicaragua, hereinafter referred to as the "Contracting Parties", [...] agreeing that a stable framework for investment will contribute to maximising the effective utilisation of economic resources and improve living standards; <b>Recognising that the development of economic and business ties can promote respect for internationally recognised labour rights; [...]</b>” (emphasis added)</p>	<p>“The Republic of Austria and Bosnia-Herzegovina hereinafter referred to as “Contracting Parties”; desiring to create favourable conditions for greater economic co-operation between the Contracting Parties; [...] <b>Reaffirming their commitment to the observance of internationally recognized labour standards;</b> Have agreed as follows: [...]</p> ” (emphasis added)

For instance, the BIT between Belgium–Luxembourg and Ethiopia (2003) provides as follows:

*“Article 6  
Labour*

1. *Recognising the right of each Contracting Party to establish its own domestic labour standards, and to adopt or modify accordingly its labour legislation, each Contracting Party shall strive to ensure that its legislation provide for labour standards consistent with the internationally recognised labour rights set forth in paragraph 6 of Article 1 and shall strive to improve those standards in that light.*
2. *The Contracting Parties recognise that it is inappropriate to encourage investment by relaxing domestic labour legislation. Accordingly, each Contracting Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such legislation as an encouragement for the establishment, maintenance or expansion in its territory of an investment.*
3. *The Contracting Parties reaffirm their obligations as members of the International Labour Organisation and their commitments under the International Labour Organisation Declaration on Fundamental Principles and Rights at Work and its Follow-up. The Contracting Parties shall strive to ensure that such labour principles and the internationally recognised labour rights set forth in paragraph 6 of Article 1 are recognised and protected by domestic legislation.*
4. *The Contracting Parties recognise that co-operation between them provides enhanced opportunities to improve labour standards. Upon request by either Contracting Party, the other Contracting Party shall accept to hold expert consultations on any matter falling under the purpose of this Article.”*

This provision is complemented by a definition of the term “labour legislation”. It reads as follows:

*“Article 1  
Definitions*

[...]

6. *The terms "labour legislation" shall mean legislation of the Kingdom of Belgium, of the Grand-Duchy of Luxembourg or of the Federal Democratic Republic of Ethiopia, or provisions thereof, that are directly related to the following internationally recognised labour rights:*
  - a) *the right of association;*
  - b) *the right to organise and bargain collectively;*

- c) *a prohibition on the use of any form of forced or compulsory labour;*
- d) *a minimum age for the employment of children;*
- e) *acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health.*"

This concept explicitly recognizes that each country has the right "to establish its own domestic labour standards and adopt or modify accordingly its labour legislation". However, it is also stated that each contracting party "shall strive to ensure" that its legislation provides for labour standards consistent with the labour rights listed in the definition of "labour legislation" cited above, which are considered to be internationally recognized labour rights. This refers to each party's obligations derived from its membership of the International Labour Organization (ILO) and the ILO Declaration on Fundamental Principles and Rights at Work.

The approach expressly recognizes that international cooperation provides contracting parties with enhanced opportunities to improve labour standards. This feature is an important conceptual innovation, as it perceives consultations between the contracting parties not only as a mechanism to promote the enforcement of commitments, but also as a means to devise joint initiatives in favour of effective development of labour rights.

Among the BITs including an explicit provision on the abstention of contracting parties from relaxing labour standards, there is a second category *applying a variation of this approach*. It is illustrated by some recent BITs of the United States, such as the BIT with Uruguay (2005), which provides as follows:

*"Article 13: Investment and Labor*

1. *The Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic labor laws. Accordingly, each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws in a manner that weakens or reduces adherence to the internationally recognized labor rights referred to in paragraph 2 as an encouragement for the establishment, acquisition, expansion, or retention of an investment in its territory. If a Party considers that the other Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.*
2. *For purposes of this Article, "labor laws" means each Party's statutes or regulations, or provisions thereof, that are directly related to the following internationally recognized labor rights:*
  - (a) *the right of association;*
  - (b) *the right to organize and bargain collectively;*
  - (c) *a prohibition on the use of any form of forced or compulsory labor;*
  - (d) *labor protections for children and young people, including a minimum age for the employment of children and the prohibition and elimination of the worst forms of child labor; and*
  - (e) *acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health.*
3. *Nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to labor concerns."*

This approach differs from the example of the BIT between Belgium–Luxembourg and Ethiopia (2003) in several ways.

First, the BIT between the United States and Uruguay (2005) addresses only such waivers from domestic labour laws as *weaken or reduce adherence to internationally recognized labour rights*. By contrast, the BIT between Belgium–Luxembourg and Ethiopia (2003) deals with the relaxation of domestic



labour legislation in general. Second, only the latter treaty obliges contracting parties to strive to *improve* internationally recognized labour rights.

Third, only the BIT between the United States and Uruguay (2005) states that "*nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to labor concerns*". Although at first sight, this provision could be read as establishing a general treaty exception for labour issues, this is not the case. The clause does not exempt the contracting parties from the obligation to comply with the BIT. Rather, it reiterates the powers that national authorities already have to oblige an investor to comply with non-discriminatory and other legitimate labour protection measures. Thereby, the BIT sends a message to civil societies. Provided that the laws adopted to ensure compliance with labour rights are not disguised discrimination or otherwise violate the treaty, there is no reason to believe that investment protection is incompatible with the protection of other legitimate national policy objectives.

Fourth, the commitment included in the BIT between the United States and Uruguay (2005) applies only to laws or regulations enacted by the *Federal Government*. A footnote to article 13.2 states that laws enacted by State legislatures, at least in the case of the United States, are excluded from the scope of this provision.<sup>130</sup> Fifth, unlike in the case of BITs of Belgium and Luxembourg, this means that the commitment included in article 13.1 is subject neither to the investor–State nor the State–State dispute settlement provisions in the agreement.<sup>131</sup> Thus, the consultations envisaged in the last sentence of article 13.1 are the only means for the contracting parties to enforce the commitment included therein.

\* \* \*

To sum up, BITs concluded in the last decade include more often general exception clauses and draft them in a more complex manner than earlier agreements. The exceptions cover a variety of issues, including taxation, essential security and public order, protection of human health and the environment, cultural diversity and prudential measures in financial services. The more frequent use of exception clauses reflects a tendency to give more weight to certain public policy concerns in connection with BITs. Another approach taken in some recent BITs is to emphasize that investment promotion and protection must not be pursued at the expense of other key policy objectives, particularly in the area of public health and safety, environmental protection and respect for core labour rights.

## L. Dispute resolution

In the context of international investment, the importance of dispute settlement provisions can be assessed from different angles. From the perspective of the investor, the most evident role of dispute settlement is to ensure that the obligations of the host country under the BIT are effectively implemented and enforced (UNCTAD 1998). Dispute settlement provisions increase the level of certainty and predictability that investors need. Moreover, these rules constitute one of the key elements in diminishing the country risk, and thus encourage investors of one contracting party to invest in the territory of the other.

Another way of assessing the importance of dispute settlement is to observe the fundamental role that rule-oriented adjudication mechanisms play in international governance, in particular for smaller developing countries.<sup>132</sup> BITs establish the parameters governing the investment relationship between the host country and the investors, and between the contracting parties. From this perspective, these treaties represent a significant step in the evolution of a rule-oriented system for investment relations.

Disputes may arise between private parties (e.g. between an investor and its supplier), between an investor of one contracting party and the other contracting party, or between the contracting parties. Very few BITs concluded since 1995 contain specific provisions on investment-related disputes between private parties. One example is the BIT between Australia and Egypt (2001), which states as follows:

*“Article 14  
Settlement of disputes between investors of the Parties*

*Each Party shall in accordance with its law:*

- (a) provide investors of the other Party who have made investments within its territory and personnel employed by them for activities associated with investments full access to its competent judicial or administrative bodies in order to afford means of asserting claims and enforcing rights in respect of disputes with its own investors;*
- (b) permit its investors to select means of their choice to settle disputes relating to investments **with the investors of the other Party**, including arbitration conducted in a third country; and*
- (c) provide for the recognition and enforcement of any resulting judgments or awards.”<sup>133</sup>*  
(emphasis added)

This article imposes an obligation on the contracting parties to provide investors of the other contracting party with access to their domestic courts, subject to their national laws. In addition, the investors of each contracting party have the right to pursue alternative means of dispute resolution. This includes arbitration in a third country.

This approach illustrates another important role of BITs: their impact on domestic reform and institutional modernization in developing countries. Providing private subjects with the right to accede to alternative means of dispute resolution in addition to domestic courts is an important element of modern administration of justice. However, in the above example this right is given only to a contracting party's own investors.

### 1. Investor–State dispute settlement

Investor–State dispute settlement provisions are a common feature of most BITs (UNCTAD 2003b). This kind of dispute resolution reflects the intention of the contracting parties to provide investors with avenues to directly defend their rights under BITs without having to depend on diplomatic protection of their home countries (UNCTAD 1998).

Having means at their disposal to ensure the host country's compliance with the obligations under BITs increases the level of certainty regarding the business environment in which investors operate in the host country. In addition, this mechanism ensures that the dispute is decided on legal grounds, thus separating legal from political considerations. Numerous BITs prevent the contracting party of which the investor is a national from exercising diplomatic protection while the investor–State arbitral proceeding is pending.<sup>134</sup> This is also an obligation under the ICSID Convention.<sup>135</sup>

Most BITs include relatively general provisions on investor–State dispute settlement (table 26). Their content is often limited to specifying the different arbitration venues available to the investor, the procedures for appointing arbitrators, and the obligation imposed on the contracting parties to consider the arbitration award to be final and binding and to provide for its enforcement in their respective territories. Thus, numerous procedural aspects of arbitration are not regulated in the BITs themselves. Instead, the contracting parties frequently refer to existing arbitration rules — often ICSID and/or UNCITRAL — to clarify these matters.

During the last decade, an emerging group of BITs has addressed investor–State dispute settlement mechanisms in more detail, providing greater guidance to the disputing parties with respect to arbitration procedures and strengthening the rule orientation of these adjudication mechanisms. NAFTA Chapter 11 had a significant influence on these BITs. More recently, it is the experience acquired from disputes under NAFTA's Chapter 11 that has impacted on the innovations in some of the new model BITs, in particular those of Canada and the United States.

Table 26. Examples of investor–State dispute settlement provisions

BIT between Mauritius and Singapore (2000)	BIT between Hong Kong (China) and the United Kingdom (1998)	BIT between Egypt and Thailand (2000)
<p style="text-align: center;">“Article 13 Investment Disputes</p> <p>1. Any dispute between an investor of one Contracting Party and the other Contracting Party in connection with an investment in the territory of the other Contracting Party shall, as far as possible, be settled amicably through negotiations between the parties to the dispute. The party intending to resolve such dispute through negotiations shall give written notice to the other of its intention.</p> <p>2. If the dispute cannot be thus resolved as provided in paragraph 1 of this Article, within 6 months from the date of the notice given thereunder, then, unless the parties have otherwise agreed, it shall, upon the request of either party to the dispute, be submitted to conciliation or arbitration by the International Centre for Settlement of Investment Disputes (called “the Centre” in this Agreement) established by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States opened for signature at Washington on 18 March, 1965 (called “the Convention” in this Agreement). For this purpose, each Contracting Party hereby irrevocably consents in advance under Article 25 of the Convention to submit any dispute to the Centre.”</p>	<p style="text-align: center;">“Article 8 Settlement of Investment Disputes</p> <p>A dispute between an investor of one Contracting Party and the other Contracting Party concerning an investment of the former in the area of the latter which has not been settled amicably, shall, after a period of three months from written notification of the claim, be submitted to such procedures for settlement as may be agreed between the parties to the dispute. If no such procedures have been agreed within that three month period, the parties to the dispute Shall be bound to submit it to arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law as then in force. The parties may agree in writing to modify these Rules.”</p>	<p style="text-align: center;">“Article 10 Settlement of Disputes Between an Investor and A Contracting Party</p> <p>1. Any dispute which may arise between a Contracting Party and an investor of the other Contracting Party shall, if possible, be settled amicably.</p> <p>2. If the dispute cannot thus be settled within six months following the date on which the dispute has been raised by either Party it may be submitted upon request of the investor (his choice will be final) either to:</p> <p>(a) The competent courts of the Contracting Party in whose territory the investment was made.</p> <p>(b) The International Centre for the Settlement of Investment Disputes (ICSID) created by the Convention on the Settlement of Investment Disputes between States and Nationals of other States opened for signature in Washington D.C. on 18 March 1965, once both Contracting Parties herein become member states thereof.”</p>

Not all recent BITs have evolved at the same pace. The majority of BITs have continued with the traditional approach of only sketching out the main features of the investor–State dispute settlement mechanisms, relying on other arbitration conventions to deal with specific procedural aspects. Even among this group of agreements, significant variations exist. It is therefore important to examine the evolution of investor–State arbitration provisions from two different angles. First, how have the elements traditionally included in investor–State dispute settlement provisions evolved during the period? Second, which new aspects have been included in BITs?

#### a. Traditional elements addressed in investor–State dispute settlement provisions

##### (i) Scope of investor–State dispute settlement procedures

The first clause of an investor–State dispute settlement provision typically defines the types of disputes to which the mechanisms apply. The BITs under review provide for a relatively broad scope of application of investor–State dispute settlement procedures. However, significant variations exist among the agreements. Some BITs apply the investor–State dispute settlement mechanism — starting with amicable negotiations — to all kinds of disputes arising between an investor of one party and the other contracting party. The BIT between Chile and New Zealand (1999) is an example:

*“Article 10  
Dispute between a Contracting Party and an investor of  
the other Contracting Party*

*Any dispute between a Contracting Party and an investor of the other Contracting Party shall, as far as possible, be settled amicably through negotiations between the parties to the dispute.”* (emphasis added)

Under this approach, the investor–State dispute settlement mechanism, starting with negotiations, applies to “any dispute between a Contracting Party and an investor of the other Party”.<sup>136</sup> Although the most likely scenario would be that the difference relates to an investment matter, one might also think of interpreting this provision in such a way that it would not be strictly necessary for the conflict to fall within that category.

Another group of BITs includes investor–State dispute settlement provisions that apply to disputes directly related to a covered investment. This approach is by far the most common, notwithstanding some differences in detail. Some BITs provide that the investor–State dispute settlement procedures apply to disputes arising “in connection with” an investment, “arising out” of an investment, “with respect to” an investment, “concerning” an investment or “related to” an investment (table 27). These formulations might be sufficiently broad to include disputes not involving an alleged violation of the BIT (UNCTAD 1998).

**Table 27. Examples of provisions applying investor-State dispute settlement procedures to all disputes related to investments**

<b>BIT between Ethiopia and the Russian Federation (2000)</b>	<b>BIT between Austria and Chile (1997)</b>
“Article 8 Settlement of Disputes between a Contracting Party and an Investor of the Other Contracting Party	“Article 9 Settlement of Disputes between a Contracting Party And an Investor of the other Contracting Party
1. Disputes which might arise between one of the Contracting Parties and an Investor of the other Contracting Party <b>concerning an investment</b> of that Investor in the territory of the former Contracting Party, shall upon a written notification by the Investor to the dispute, be settled amicably between the parties concerned. [...]” (emphasis added)	(1) With a view to an amicable solution of disputes between a Contracting Party and an investor of the other Contracting Party, <b>which arise out of an investment covered</b> by this Agreement, consultations will take place between the parties concerned. [...]” (emphasis added)

Other BITs apply their investor–State dispute settlement mechanism to disputes involving a provision of the agreement. The scope is not limited to those instances where the host country has breached an obligation of the agreement. For example, disputes may relate to differences regarding the application or interpretation of a particular clause of the BIT, or other investment-related instruments providing additional rights to the investor.

Some treaties stipulate that the investor–State dispute settlement procedures apply to disputes “concerning an obligation” of contracting parties under the BIT. The BIT between China and Guyana (2003) demonstrates this approach:

*“Article 9  
Settlement of disputes between one Contracting  
Party and an investor of the other Contracting Party*

1. For purposes of this Agreement, an “investment dispute” is a dispute between a Contracting Party and an investor of the other Contracting Party, **concerning an obligation** of the former under this Agreement in relation to an investment of the latter. [...]” (emphasis added)

Other BITs provide that the dispute has to relate to “*interpretations or applications of the agreement*”, while yet others state that these procedures shall apply to disputes which arise “*within the terms*” of the agreement.

An example of this trend is Article 8.1 of the BIT between Chile and Peru (2000), which applies to “[...] *the disputes between the Contracting Parties relating to the interpretation or application of the Agreement*” (emphasis added). Article IX.1 of the BIT between Chile and South Africa (1998) illustrates the second approach, and applies the investor–State dispute settlement provisions to “[...] *any disputes which arise within the terms of this Agreement, between a Party and an investor of the other Party*” (emphasis added).

A variation of this approach limits the application of the investor–State dispute settlement procedures to one or very few obligations in the BIT. This is the case of some agreements that only allow the investor to invoke the mechanism with regard to the amount of compensation resulting from nationalization or expropriation. A case in point is the BIT between Mauritius and Swaziland (2000):<sup>137</sup>

“Article 8  
*Settlement of disputes between an investor  
and a Contracting Party*”

[...]

- (2) *If the dispute cannot be settled through negotiations within six months, either party to the dispute shall be entitled to initiate judicial action before the competent court of the Contracting Party accepting the investment.*
- (3) *If a dispute involving the amount of compensation resulting from expropriation, nationalisation, or other measures having effect equivalent to nationalisation or expropriation, mentioned in Article 6 cannot be settled within six months after resort to negotiation as specified in paragraph (1) of this Article by the investor concerned, it may be submitted to an international arbitral tribunal established by both parties.*  
*The provisions of this paragraph shall not apply if the investor concerned has resorted to the procedure specified in paragraph (2) of this Article. [...]*” (emphasis added)

This approach means that the investor is not allowed to invoke the dispute settlement mechanism with regard to a dispute arising from any other obligation in the BIT. For those kinds of conflicts, the only means available to the investor are negotiations with the host Government or judicial action before the competent tribunals of the host country, provided that after six months of negotiations the matter has not been resolved.

Another group of BITs includes investor–State dispute settlement mechanisms with a narrower scope of application. They require that the dispute be related to the provisions of the treaty, an investment agreement or investment authorization. United States' BITs of the second part of the 1990s typically use this approach. An illustration is the BIT with Jordan (1997):

“Article IX  
*Settlement of disputes between one Contracting Party and a national or company of the other  
Contracting Party*”

1. *For purposes of this Treaty, an investment dispute is between a Contracting Party and a national or company of the other Contracting Party arising out of or relating to an investment authorization, and investment agreement or an alleged breach of any right conferred, created or recognized by this Treaty with respect to a covered investment. [...]*”

Over the last 10 years, a fifth category of BITs has emerged, one that requires more than an alleged breach of an obligation in the BIT for the investor–State dispute settlement mechanisms to be activated. This approach also requires that the investor has incurred a loss or damage as a result of the violation. It is used more frequently, especially in agreements with more specific procedural provisions on dispute settlement.

The requirements of this approach are threefold: first, a claim of a breach of an obligation; second, the existence of a loss or damage for the investor; and third, a causal link between the two. This approach reinforces the notion that arbitral procedures are mainly geared to addressing conflicts related to property rights. Within this logic, it is the loss or damage inflicted upon the investor that the arbitral procedures attempt to remedy. This method is also used in most recent BITs of Austria, Canada, Japan, Mexico and the United States (table 28).

**Table 28. Examples of investor–State dispute settlement provisions requiring breach of obligations and damage or loss to the investor**

BIT between the United States and Uruguay (2005)	BIT between Japan and the Republic of Korea (2002)
<p>“Article 24: Submission of a Claim to Arbitration</p> <p>1. In the event that a disputing party considers that an investment dispute cannot be settled by consultation and negotiation:</p> <p>(a) the claimant, on its own behalf, may submit to arbitration under this Section a claim</p> <p>(i) that the respondent has breached</p> <p>(A) an obligation under Articles 3 through 10,</p> <p>(B) an investment authorization, or</p> <p>(C) an investment agreement;</p> <p>and</p> <p>(ii) that the claimant has <b>incurred loss or damage</b> by reason of, or arising out of, that breach; [...]” (emphasis added)</p>	<p>“Article 15</p> <p>1. For the purposes of this Article, an investment dispute is a dispute between a Contracting Party and an investor of the other Contracting Party that has <b>incurred loss or damage</b> by reason of, or arising out of, an alleged breach of any right conferred by this Agreement with respect to an investment of an investor of that other Contracting Party.” (emphasis added)</p>

It should be noted that the scope of application of the investor–State dispute settlement procedures not only depends on the specific provisions addressing this subject, but is also connected with the particular wording of the substantive treaty obligations. Even if the dispute settlement provisions state that arbitration is limited to those disputes deriving from an alleged breach of an obligation under the agreement, BITs may contain different solutions concerning the scope of this restraint. This is particularly the case for BITs that include an “umbrella clause”, which incorporates into the treaty any other obligation that a contracting party may have assumed with respect to an investor (see section I.4 above).

## (ii) Legal standing

The determination of legal standing for the purposes of investor–State dispute settlement is relatively straightforward. In principle, these procedures are accessible to investors of one contracting party that have invested in the territory of the other contracting party. Thus, in general, any investor of a contracting party has legal standing in arbitration procedures against the other contracting party.

One could ask whether a foreign subsidiary incorporated under the laws of a host country could submit a dispute with that country. Usually, such a legal entity would be considered a company of the host country rather than a foreign investor, and consequently would not have access to investor–State dispute settlement procedures.

Since the legal entity is a subsidiary of a foreign investor, some BITs under review explicitly allow it to submit a dispute with the latter, provided that immediately prior to the dispute, it has been owned or controlled by nationals of the other contracting party. The BIT between Japan and the Russian Federation (1998) exemplifies this latter approach:

*“Article 11*

[...]

5. *In case when a legal dispute arises in respect of the capital investments made by a company of each Contracting Party and such a company is controlled by investors of the other Contracting Party as of the date when such a company files a petition addressed to the former Contracting Party claiming the dispute's being referred to the arbitration tribunal, then for the purposes of the provisions of the present article such a company of the former Contracting Party shall be deemed a company of the other Contracting Party.”*

Thus, according to this provision, a company established under the laws of country A could submit a dispute against the same country A if the enterprise is owned or controlled by investors of country B.

This approach whereby a local company is considered to be a foreign entity owing to the foreign nationality of the shareholders has also been followed in the ICSID Convention. Under its article 25(2), the disputing parties may agree that, for the purposes of ICSID arbitration, a company shall be considered to be a company of one contracting party if, immediately prior to the action giving rise to the dispute, nationals of that party owned or controlled it.

Several BITs explicitly provide for this consent — in some cases, only for the purposes of article 25(2) of the ICSID Convention. A case in point is the BIT between Ethiopia and Malaysia (1998):

*“Article 7**Settlement of Investment Disputes Between a Contracting Party and an Investor of the Other Contracting Party*

[...]

3. *A company which is incorporated or constituted under the laws in force in the territory of one Contracting Party and which, before such a dispute arises, is owned by investors of the other Contracting Party shall in accordance with Article 25(2) (b) of the Convention be treated for the purpose of this Convention as a company of the other Party.”*

**(iii) Prerequisites for activating the dispute settlement mechanism**

BITs usually require that, prior to the submission of a dispute to any legal adjudication mechanism, several conditions have to be fulfilled. The most frequent prerequisites are the following: first, good faith consultations between the disputing parties in order to attempt to settle the difference amicably; second, the consent of both parties to submit the dispute to arbitration; and third, clarification of how the submission will interact with domestic judicial and administrative adjudication procedures. Over the last decade, an increasing number of BITs have specified in greater detail other procedural requirements.

*1. Consultations*

As a first step in conflict resolution, BITs usually require that the parties to the dispute hold consultations or negotiations in order to resolve it amicably.

In order to ensure that the parties to the dispute actually make an effort to settle their differences amicably, most BITs provide for a minimum period to be respected before the investor may request the establishment of an arbitral tribunal. Most BITs examined provide for a consultation period of six months, as is the case of the BIT between Benin and Ghana (2001) (table 29). Other BITs include shorter periods, very often three months, such as the BIT between Chile and the Netherlands (1998). A few agreements do not specify how long the consultation period should be, such as the BIT between Australia and India (1999).<sup>138</sup>

*2. Consent*

A fundamental feature of alternative means of dispute resolution such as arbitration is their voluntary nature. Thus, arbitration procedures can be invoked only once the investor and the host country have consented to resolve their quarrel in this manner. The contracting parties may provide their consent in

advance of a dispute by including in the BIT a clause “on compulsory jurisdiction”. Such a provision gives investors the certainty that the host country cannot unilaterally withdraw its consent and force the dispute to be adjudicated in local administrative or judicial tribunals.

**Table 29. Examples of provisions establishing consultation periods as a pre-requisite for arbitration**

BIT between Benin and Ghana (2001)	BIT between Chile and the Netherlands (1998)	BIT between Australia and India (1999)
<p>“Article 9 Settlement of Investment Disputes between a Contracting Party and a National or Company of the Other Contracting Party</p> <p>1. Disputes between a national or company of one Contracting Party and the other Contracting Party concerning an obligation of the latter under this agreement in relation to an investment of the former which have not been amicably settled shall, <b>after a period of six months</b> from written notification of a claim, be submitted at the first instance to the competent court of the Contracting Party for decision, or to international arbitration if either party to the dispute so wishes. [...]” (emphasis added)</p>	<p>“Article 8 Settlement of Disputes Between a Contracting Party and a National of the Other Contracting Party</p> <p>(1) Any legal dispute between one Contracting Party and a national of the other Contracting Party concerning an investment of the latter in the territory of the former shall, if possible, be settled amicably.</p> <p>(2) If such a dispute cannot be settled according to the provisions of paragraph 1 of this article within a period of <b>three months</b> from the date either party to the dispute requested amicable settlement, the dispute shall at the request of the national concerned be submitted either to the judicial procedures provided by the internal law of the Contracting Party in the territory of which the investment has been made, or to international arbitration. [...]” (emphasis added)</p>	<p>“Article 12 Settlement of disputes between an investor and a Contracting Party</p> <p>1. Any dispute between an investor of one Contracting Party and the other Contracting Party in relation to an investment of the former under this Agreement shall, as far as possible, be settled amicably through negotiations between the Parties to the dispute.</p> <p>2. Any such dispute which has not been amicably settled may, if both Parties agree, be submitted;</p> <p>(a) for resolution, in accordance with the law of the Contracting Party which has admitted the investment to that Contracting Party's competent judicial or administrative bodies; or</p> <p>(b) to international conciliation under the Conciliation Rules of the United Nations Commission on International Trade Law. [...]”</p>

The BITs under review have followed various approaches concerning the expression of contracting parties' consent. One method, applied in a significant number of BITs, is to provide for the contracting parties' explicit and irrevocable consent to submit a dispute to arbitration if a covered investor so requests. The BIT between Mexico and Portugal (1999) is an example of that method:

*“Article 10  
Contracting Party Consent*

*Each Contracting Party hereby gives its unconditional consent to the submission of a dispute to international arbitration in accordance with this Part.”*

Other BITs apply a different approach, albeit with similar results, which requires that the contracting parties *shall agree* that an investment dispute be submitted to arbitration. The BIT between Australia and Lithuania (1998) illustrates this method. It obliges the contracting parties to express their consent if an investor requests that a dispute be submitted to arbitration procedures under the ICSID Convention.

*“Article 13  
Settlement of disputes between a Party and  
an investor of the other Party*

[...]

3. *Where a dispute is referred to the Centre pursuant to paragraph 2(b) of this Article:*



- (a) *where that action is taken by an investor of one Party, the other Party shall consent in writing to the submission of the dispute to the Centre within thirty days of receiving such a request from the investor; [...]*

This clause means that the arbitration forum shall not have jurisdiction until the contracting party involved gives its consent. However, refusal to give consent would be contrary to the BIT, and would enable the other contracting party to pursue its right under the State–State dispute settlement mechanism. A variation of this approach is to provide that if the dispute involves an autonomous subnational authority, the latter must also consent to arbitration procedures. The BIT between France and Uganda (2002) demonstrates this particular approach:

*“Article 7*

*Settlement of disputes between an investor and a Contracting Party*

[...]

*In the case where the dispute may involve the responsibility for actions or omissions of sub-sovereign entities of the Contracting Parties as defined in article 1 paragraph 7 of the present Agreement, the fore mentioned sub-sovereign entity must give their unconditional consent to the use of arbitration of the International Centre for the Settlement of Investment Disputes (ICSID), as defined in article 25 of the Convention for the settlement of disputes in respect of investments occurring between States and nationals of other States signed in Washington on March 18, 1965.”*

Yet another approach is to reserve the right of the host country to consent to arbitration. Within this group of agreements, some BITs include an explicit reservation. The BIT between Argentina and New Zealand (1999) is an example:

*“Article 12*

*Disputes between a Contracting Party and an investor of the other Contracting Party*

[...]

- (3) *In the case of international arbitration, unless the parties to the dispute agree otherwise, the dispute shall be submitted to either:*
- (a) *The International Centre for the Settlement of Investment Disputes (ICSID) created by the Convention on the Settlement of Investment Disputes between States and Nationals of other States opened for signature in Washington on 18 March 1965; or,*
  - (b) ***If both parties to the dispute agree, arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law as then in force.***
- (4) *Paragraph (3) of this Article **shall not constitute, by itself, the consent of the Contracting Party** required in Article 25(1) of the Convention on the Settlement of Investment Disputes opened for signature in Washington on 18 March 1965.” (emphasis added)*

This approach allows a contracting party to decide on a case-by-case basis whether to consent to the submission of an investment-related dispute to international arbitration. This clause not only explicitly states that the contracting parties have to consent to submit a dispute to ICISD, but also provides for the possibility of settling a dispute under the UNCITRAL rules if both parties to the dispute so wish.

A fourth category of agreements makes no explicit reference to the consent of the contracting parties with respect to arbitration. The BIT between Chile and Indonesia (1999) typifies this approach:

*“Article IX*

*Settlement of disputes between a Contracting Party and an investor of the other Contracting Party*

- (1) *With a view to an amicable solution of disputes, which arise within the terms of this Agreement, between a Contracting Party and an investor of the other Contracting Party consultations and negotiations will take place between the parties concerned.*
- (2) *If these consultations and negotiations do not result in a solution within four months from the date of a written notification for settlement, the investor may submit the dispute either:*
  - (a) *to the competent tribunal of the Contracting Party in whose territory the investment was made, or*
  - (b) *to international arbitration of the International Centre for Settlement of Investment Disputes (ICSID), created by the Convention on the Settlement of Investment Disputes between States and nationals of other States opened for signature in Washington on March 18, 1965.*
- (3) *Once the investor has submitted the dispute to the competent tribunal of the Contracting Party in whose territory the investment was made or to international arbitration, that election shall be final.*
- (4) *The award shall be final and binding; it shall be executed according to its respective national laws.*
- (5) *Once a dispute has been submitted to the competent tribunal or international arbitration in accordance with this Article, neither Contracting Party shall pursue the dispute through diplomatic channels.”*

The ICSID Convention requires the unambiguous intention of the disputing parties to submit their quarrel to ICSID. This requirement is fulfilled if, as in the above example, the disputing host country allows the foreign investor to submit the case to arbitration. The provision does not expressly reserve the contracting parties' consent to arbitration.

*3. Exhaustion of local remedies*

A question that often arises in investor–State dispute settlement procedures is whether an investor has to exhaust local remedies before being allowed to submit the claim to international arbitration. Historically, exhaustion of local remedies was considered to be a necessary step prior to elevating a dispute to an international level.<sup>139</sup> International arbitration was conceived as a subsidiary means of conflict resolution, available to foreign investors only once they had failed to resolve their disputes within the jurisdiction of the host country. Thus, 30 years ago, a number of BITs made the right of invoking international arbitration procedures conditional on the prior attempt of the investor to resolve the quarrel in local courts. However, this trend gradually changed (UNCTAD 1998).

Over the last 10 years, BITs have reinforced the approach whereby international arbitration is regarded as an alternative rather than as a subsidiary means of adjudication. Consequently, most of these agreements do not require investors to exhaust local remedies as a condition for acceding to international arbitration. Within this approach, however, different techniques have been used. Most BITs do not even mention exhaustion of local remedies. A number of BITs concluded since 1995 explicitly include an obligation for the parties not to request the exhaustion of local remedies if the investor has opted to submit the dispute to international arbitration. The BIT between Austria and the United Arab Emirates (2001) exemplifies this approach:

*“Article 10*

*Settlement of disputes between an investor and a Contracting Party*

[...]

- (5) *If the investor chooses to file for arbitration, the host Contracting Party agrees not to request the exhaustion of local settlement procedures. [...]*”

Similarly, some BITs state that the requirement for the exhaustion of local remedies is waived by virtue of the host country's consent to arbitration. The BIT between Cambodia and Croatia (2001) is a case in point:

*“Article 10  
Settlement of disputes between a Contracting Party and  
an investor of the other Contracting Party*

[...]

*2.b) [...] In case of arbitration, each Contracting Party, by this Agreement irrevocably consents in advance, even in the absence of an individual arbitral agreement between the Contracting Party and the investor, to submit any such dispute to this Centre. This consent implies the renunciation of the requirement that the internal administrative or judicial remedies should be exhausted [...]*”

These examples converge in the same direction, in the sense that they all relieve the investor of the obligation to exhaust local remedies as a condition for submitting a dispute to international arbitration. However, a limited number of agreements require that the investor should first exhaust the administrative instances of the host country. Only thereafter is the investor allowed to pursue international arbitration.<sup>140</sup> The BIT between China and Côte d'Ivoire (2002) is a case in point:

*“Article 9  
Settlement of disputes between investors and  
One Contracting Party*

[...]

*3. If such dispute cannot be settled amicably through negotiations, any legal dispute between an investor of one Contracting Party and the other Contracting Party in connection with an investment in the territory of the other Contracting Party shall have exhausted the domestic administrative review procedure specified by the laws and regulations of that Contracting Party, before submission of the dispute the aforementioned arbitration procedure [...]*”

Within the category of agreements requiring the investor to pursue a remedy in local courts before submitting the dispute to international arbitration, some provide that it shall initially be attempted to settle the dispute locally. Only if a resolution has not been reached within a certain period of time is the claim allowed to be submitted to international arbitration. The BIT between Belgium–Luxembourg and Botswana (2003) exemplifies that approach:

*“Article 12  
Settlement of Investment Disputes*

[...]

*2. In the absence of an amicable settlement by direct agreement between the parties to the dispute or by conciliation through diplomatic channels within six months from the notification, the dispute shall be submitted, at the first instance to a court competent jurisdiction of the latter Contracting Party for a decision. Either party may, six months after the submission of the dispute to a court of competent jurisdiction, refer the dispute to international arbitration.”*

#### *4. Other procedural requirements*

In addition to the general requirements examined above, an increasing number of BITs deal with different aspects of the arbitration procedures in greater detail. While typically most treaties devote only one article to investor–State dispute settlement, some BITs include a whole section, comprising about 10 detailed articles. This reflects contracting parties' interest in deepening the rule orientation of these mechanisms and in promoting greater predictability in their implementation. For instance, several BITs enumerate all specific

procedural steps an investor must follow in order to properly initiate arbitration. Treaties following this approach normally impose a number of requirements on foreign investors.

First, within certain periods of time, the investor has to give formal notice to the defending contracting party of its intention to submit the dispute to arbitration. The document must describe the basic elements of the dispute. The BIT between Mexico and the Republic of Korea (2000) provides as follows:

*“Article 8  
Arbitration: Scope and Standing and Time Periods*

[...]

- (12) *A dispute may be submitted to arbitration provided that the investor has delivered to the Contracting Party, party to the dispute, written notice of his intention to submit a claim to arbitration at least 90 days in advance, but not later than 3 years from the date that either the investor or the enterprise of the other Contracting Party that the investor owns or controls, first acquired or should have acquired knowledge of the events which gave rise to the dispute.*
- (13) *The notice referred to in paragraph (12) shall specify:*
- (a) the name and address of the disputing investor and, where a claim is made by an investor of a Party on behalf of an enterprise, the name and address of the enterprise;*
  - (b) the provisions of this Agreement alleged to have been breached and any other relevant provisions;*
  - (c) the issues and the factual basis for the claim; and*
  - (d) the relief sought and the approximate amount of damages claimed. [...]*

Second, the investor must give in writing its consent to arbitration in accordance with certain procedures set out in the BIT, and explicitly waive the right to initiate before any administrative tribunal or court under the law of the host country, or any other dispute settlement procedures, any proceedings with respect to the disputed measure of the disputing contracting party.<sup>141</sup>

The approach used in NAFTA’s Chapter 11 arbitration mechanism significantly influenced this technique of specifying in the text of the treaty itself a series of procedural matters. This explains why, in the mid-1990s, Canada, Mexico and the United States started to regulate investor–State dispute settlement in greater detail. This approach is, however, not limited to NAFTA countries.<sup>142</sup>

#### **(iv) The arbitration forum**

Investor–State dispute settlement provisions in BITs refer to various existing international arbitration conventions to prescribe the rules governing the arbitration. Although earlier BITs contained each contracting party’s consent only to ICSID arbitration, the more recent trend has been to give foreign investors the additional right to submit disputes to other arbitration forums. Not all countries are parties to the ICSID Convention, and consequently, this forum is not always available (UNCTAD 1998).

The institutional arbitration forums most commonly referred to in BITs are ICSID and the ICSID Additional Facility Rules — applicable if only one of the contracting parties is a party to the ICSID Convention. Other BITs mention the Court of Arbitration of the International Chamber of Commerce (ICC) in Paris or the Arbitration Institute of the Chamber of Commerce of Stockholm as possible venues. BITs also provide for the possibility of submitting the dispute to ad hoc arbitration. The most frequent approach has been for the contracting parties to agree to conduct such proceedings in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL).<sup>143</sup>

Several issues arise when addressing the question of the arbitration forum in BIT negotiations: first, whether the investor will have more than one option available; second, if this is the case, whether the investor will have the right to choose the forum to which the claim will be submitted; and third, whether the variety of options will be exhaustive or left open for later agreement by the parties.

Regarding the first issue, the trend towards providing more than one possible arbitration forum to adjudicate the dispute has continued in the review period. Most BITs provide for the possibility of settling

the investment dispute under ICSID, ICSID's Additional Facility Rules or the UNCITRAL rules. The BIT between Indonesia and Mozambique (1999) illustrates this approach. However, other BITs provide the investor with different arbitration venues, such as the ICC and the Arbitration Institute of the Chamber of Commerce of Stockholm. The BIT between the Russian Federation and Ukraine (1998) and the BIT between the Republic of Korea and Trinidad and Tobago (2002) are two examples. On the other hand, a number of treaties allow only for ICSID-based arbitration, leaving the investor with domestic tribunals as the alternative choice. The BIT between Malaysia and Saudi Arabia (2000) is a case in point (table 30).

Among the BITs providing more than one possible arbitration venue, the prevailing trend is to allow the investor to choose the specific forum in which the dispute will be adjudicated. However, some treaties, such as the BIT between Canada and Costa Rica (1997), refer to ICSID, ICSID's Additional Facility and UNCITRAL in a subsidiary manner, allowing the use of one forum only if the first option — ICSID — is not available.

*“Article XII  
Settlement of disputes between an investor and  
the host Contracting Party*

[...]

4. *The dispute may be submitted to arbitration under:*

- (a) *The International Centre for the Settlement of Investment Disputes (ICSID), established pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of other States, opened for signature at Washington D.C. on 18 March, 1965 (“ICSID Convention”), if both the disputing Contracting Party and the Contracting Party of the investor are parties to the ICSID Convention; or*
- (b) *the Additional Facility Rules of ICSID, if either the disputing Contracting Party or the Contracting Party of the investor, but not both, is a party to the ICSID Convention; or*
- (c) *and ad hoc arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL) **in case neither Contracting Party is a member of ICSID, or if ICSID declines jurisdiction.***” (emphasis added)

The rationale of this approach is to provide the contracting parties with greater certainty as to the forum where the dispute is to be settled.

In addition to the usual arbitration venues already mentioned, some BITs permit the investor and the host country to settle the quarrel according to any other dispute settlement mechanism upon which they agree. For instance, under article 9.3 (a) of the BIT between Bahrain and the United States (1999), the investor may choose from among ICSID, the Additional Facility of ICSID, ad hoc arbitration under UNCITRAL — if ICSID-based arbitration is not available — or any other arbitral institution or rules agreed upon by the parties to the dispute. Furthermore, the BIT between Hong Kong (China) and the United Kingdom (1998) allows the parties to the dispute to agree, in the first instance, on the particular arbitration rules. Only if the parties cannot agree does UNCITRAL operate as a fall-back alternative:

*“Article 8  
Settlement of Investment Disputes*

*A dispute between an investor of one Contracting Party and the other Contracting Party concerning an investment of the former in the area of the latter which has not been settled amicably, shall, after a period of three months from written notification of the claim, be submitted to such procedures for settlement as may be agreed between the parties to the dispute.*

*If no such procedures have been agreed within that three month period, the parties to the dispute shall be bound to submit it to arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law as then in force. The parties may agree in writing to modify these Rules.”*

Table 30. Examples of provisions indicating arbitration forums

BIT between Malaysia and Saudi Arabia (2000)	BIT between the Russian Federation and Ukraine (1998)	BIT between the Republic of Korea and Trinidad and Tobago (2002)	BIT between Indonesia and Mozambique (1999)
<p>“Article 11 Settlement of Investment Disputes Between A Contracting Party and an Investor of the other Contracting Party</p> <p>[...] 2. If the dispute cannot be settled in the way prescribed in paragraph (1) of this Article within six (6) months from the date when the request for the settlement has been submitted, it shall be at the request of the investor filed to the competent court of law of the Contracting party in whose territory the investments was made or filed for arbitration under the <b>Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of Other States</b>. [...]” (emphasis added)</p>	<p>“Article 9 Resolution of Disputes Between a Contracting Party and the Investor of the other Contracting Party</p> <p>[...] 2. In the event the dispute cannot be resolved through negotiations within six months as of the date of the written notification as mentioned in Item 1 hereof above, then the dispute shall be passed over for consideration to:</p> <p>a) a competent court or an arbitration court of the Contracting Party, on whose territory the investments were carried out; b) the Arbitration Institute of <b>the Chamber of Commerce in Stockholm</b>, c) an "ad hoc" arbitration tribunal, in conformity with the Arbitration Regulations of <b>the United Nations Commission for International Trade Law (UNCITRAL)</b>. [...]” (emphasis added)</p>	<p>“Article 8 Settlement of Investment Disputes between a Contracting Party and an Investor of the Other Contracting Party</p> <p>[...] 3. If the dispute cannot be settled within six (6) months from the date on which the dispute has been raised by either party, and if the investor waives the rights to initiate any proceedings under paragraph 2 of this Article with respect to the same dispute, the dispute shall be submitted upon request of the investor of the Contracting Party to:</p> <p>(a) <b>the International Center for Settlement of Investment Disputes (ICSID)</b> established by the Washington Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of other States; or (b) <b>the Court of Arbitration of the International Chamber of Commerce</b>; or (c) an international arbitrator or ad hoc arbitral tribunal to be appointed by a special agreement or established under the Arbitration Rules of <b>the United Nations Commission on International Trade Law</b>. [...]” (emphasis added)</p>	<p>“Article VII Settlement of Disputes between an Investor and a Contracting Party</p> <p>[...] 3. Where the dispute is to be referred to international arbitration, the investor and the Contracting Party involved in the dispute may agree to refer the dispute either to:</p> <p>a.) <b>the International Center for Settlement of Investment Disputes (ICSID)</b> under the rules of the International Convention on the Settlement of Investment Disputes between States and Nationals of other States opened for signature at Washington, D.C. on 18 March 1965, when such Contracting Party has become a party to the said Convention.</p> <p>As long as this requirement is not met each Contracting Party agrees the dispute may be settled under the rules of <b>the Additional Facility</b> of the Administration of proceedings by the Secretariat of <b>ICSID</b>.</p> <p>b) an ad hoc tribunal to be established under the arbitration rules of <b>the United Nations Commission on International Trade Law (UNCITRAL)</b>.” (emphasis added)</p>

The prevailing trend among recent BITs, however, is to provide for an exhaustive list of options rather than to leave open the possibility for the parties to the dispute to agree on any kind of dispute resolution.

#### (v) Selection of arbitrators

As previously explained, numerous BITs provide for the possibility of settling the dispute through ad hoc arbitration—that is, arbitration before a single individual, or a tribunal specially constituted for that particular dispute (UNCTAD 1998). In order to make such an option viable, it is necessary for the BIT to indicate the procedures for the appointment of the arbitrators. The BITs examined have basically followed the already existing approaches.

One group of agreements refers only to an existing set of arbitration rules — most commonly the UNCITRAL rules or the ICC arbitration procedures — to govern the selection procedures of the arbitrators. The BIT between Armenia and Austria (2001) exemplifies this method:

*“Article 12  
Means of Settlement, Time Periods*

*(1) A dispute between a Contracting Party and an investor of the other Contracting Party shall, if possible, be settled by negotiation or consultation. If it is not so settled, the investor may choose to submit it for resolution:*

*[...]*

*c) in accordance with this Article to:*

- i) [...]“the ICSID Convention” if the Contracting Party of the investor and the Contracting Party, party to the dispute, are both parties to the ICSID Convention;*
- ii) the Centre under the rules governing the Additional Facility for the Administration of Proceedings by the Secretariat of the Centre, if the Contracting Party of the investor or the Contracting Party, party to the dispute, but not both, is a party to the ICSID Convention;*
- iii) a sole arbitrator or an ad hoc arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (“UNCITRAL”);*
- iv) the International Chamber of Commerce, by a sole arbitrator or an ad hoc tribunal under its rules of arbitration.” (emphasis added)*

Other BITs provide that ad hoc arbitration shall entail the constitution of a tribunal, and for that purpose, they include specific appointment procedures. Usually, the arbitral tribunal shall have three members, allowing each contracting party to select one arbitrator, and these two arbitrators agree on the appointment of the third arbitrator. The latter acts as the chair of the arbitral tribunal, and usually cannot be a national of either of the contracting parties. BITs that include appointment procedures also provide that, if for any reason, the appointments are not made within the agreed time frames or arbitrators cannot agree on the chair of the tribunal, a third person shall act as the appointment authority. Usually the latter is the President or Vice-President of the International Court of Justice, although some BITs delegate this role to the Secretary-General of ICSID. The BIT between China and Guyana (2003) is a case in point:

*“Article 9  
Settlement of disputes between one Contracting  
Party and an investor of the other Contracting Party*

*[...]*

- 5. Without prejudice to Paragraph 4 of this Article, the ad hoc Tribunal referred to in paragraph 4 (b) shall be constituted for each individual case in the following way: each party to the dispute shall appoint one arbitrator and these two shall select a national of a third State which has diplomatic relations with both Contracting Parties as the Chairman. The first two Arbitrators shall be appointed within two months and the Chairman within four months of the written notice requesting arbitration by either party to the dispute to the other.*
- 6. If within the period specified in Paragraph 5 above, the Tribunal has not yet been constituted, either party to the dispute may invite the Secretary General of the International Centre for the Settlement of Investment Disputes to make the necessary appointments.”*

A third group of BITs mixes the two approaches explained above and, in principle, refers to an existing set of arbitration rules. At the same time, they provide for some specific modifications agreed by the contracting parties. For instance, the BIT between Ghana and India (2002) refers to the UNCITRAL arbitration rules. However, in this particular case, the contracting parties opted to include some alterations regarding the appointment procedures of the arbitral tribunal:

*“Article 9  
Settlement of disputes between an investor  
and a Contracting Party*

[...]

(3) [...] *The Arbitration procedure shall be as follows:*

- (a) *If the Contracting Party of the Investor and the other Contracting Party are both parties to the Convention on the Settlement of Investment Disputes between States and nationals of other States, 1965, and the investor consents in writing to submit the dispute to the International Centre for the Settlement of Investment Disputes, such a dispute shall be referred to the Centre; or*
- (b) *If both parties to the dispute so agree, under the Additional Facility for the Administration of Conciliation, Arbitration and Fact-Finding proceedings; or*
- (c) *to an ad hoc arbitral tribunal by either party to the dispute in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law, 1976, subject to the following modifications:*
  - (i) *The appointing authority under Article 7 of the Rules shall be the President, the Vice-President or the next senior Judge of the International Court of Justice, who is not a national of either Contracting Party. The third arbitrator shall not be a national of either Contracting Party.*
  - (ii) *The parties shall appoint their respective arbitrators within two months.*
  - (iii) *The arbitral award shall be made in accordance with the provisions of this Agreement and shall be binding for the parties in dispute.” (emphasis added)*

**(vi) Subrogation of insurance claims**

Numerous capital-exporting countries have developed insurance programmes to protect the investments of their investors abroad against political risks, such as expropriation or transfer restrictions. These programmes, however, do not purport to relieve host countries of their responsibility in the event that a violation of the BIT generates damage or loss to the foreign investor. In order to enable insurance agencies to recover what they have paid to investors, most BITs include a provision on subrogation. Accordingly, the contracting parties recognize the subrogation to the home country of any rights that the investor may have against the host country as a result of a violation of the BIT, provided that the former has paid compensation for the loss under an insurance contract.

Practically all BITs concluded since 1995 include a provision on subrogation. Although the wording may vary, the substantial content of these clauses is very similar; for example, the BIT between Benin and Ghana (2001) states as follows:

*“Article 8  
Subrogation*

1. *If one Contracting Party or its designated agency makes a payment under an indemnity given in respect of an investment in the territory of the other Contracting Party, the latter Contracting Party shall recognize the assignment to the former Contracting Party or its designated agency by law or any legal transaction of all the rights and claims of the party indemnified and that former Contracting Party or its designated agency is entitled to exercise such rights and enforce such claims by virtue of its subrogation, to the same extent as the party indemnified.*
2. *The former Contracting Party or its designated Agency shall be entitled in all circumstances to the same treatment in respect of the rights and claims acquired by it by virtue of the assignment and any payments received in pursuance of those rights and claims as the party indemnified was entitled to receive by virtue of this Agreement in respect of the investment concerned and its related returns.*
3. *Any payments received by the former Contracting Party or its designated Agency in pursuance of the rights and claims acquired shall be freely available to the former Contracting Party for the purpose of meeting any expenditure incurred in the territory of the latter Contracting Party.”*



The commitment to recognize subrogation in situations such as that illustrated above raises the question of how the dispute settlement procedures of the BIT would operate with respect to this issue. Who would have standing to bring a claim before the host country that has generated the loss? Would it be the investor who has received a payment under an insurance contract or the other contracting party in favour of which the subrogation operates? The contracting party could always invoke the State–State dispute settlement mechanism to enforce the recognition of the subrogation provision. Regarding the possibility of the investor’s seeking compensation under the investor–State dispute settlement mechanisms, recent BITs have adopted different approaches.

Many BITs provide investors with the right to seek redress through investor–State arbitration, even if they have already received compensation under an insurance contract. Under this approach, the investor would initially seek compensation from the host country, and then, arguably, transfer the amount to the insurance agency that had subrogated the rights of the former. The BIT between Brunei Darussalam and the Republic of Korea (2000) exemplifies this method:

*“Article 8  
Settlement of Investment Disputes between  
a Contracting Party and an Investor of the other Contracting Party*

[...]

7. *During arbitration proceedings or the enforcement of an award, the Contracting Party involved in the dispute shall not raise the objection that the investor of the other Contracting Party has received compensation under an insurance contract in respect of all or part of its loss.”*

A second, equally numerous group of BITs do not address the question of whether the investor still has standing in investor–State dispute settlement procedures if compensation has been previously received. As explained in subsection a (i) above, the scope of the investor–State dispute settlement mechanisms in most BITs is relatively ample. There is no particular requirement for an investor to have standing in addition to being a covered investor under the agreement.<sup>144</sup> Thus, despite the lack of an explicit provision, there is, in principle, no impediment to an investor's seeking redress under investor–State arbitration even in these particular circumstances.

A third group of BITs contain provisions which suggest that once subrogation has taken place, it would be up to the contracting party, and not the investor, to seek compensation for the amount paid to the latter. The BIT between Turkey and Yemen (2000) exemplifies this approach:

*“Article V  
Subrogation*

1. *If the investment of an investor of one Party is insured against non-commercial risks under a system established by law, any subrogation of the insurer which stems from the terms of the insurance agreement shall be recognized by the other Party.*
2. *The insurer shall not be entitled to exercise any rights other than the rights which the investor would have been entitled to exercise.*
3. ***Disputes between a Party and an insurer shall be settled in accordance with the provisions of Article VII [State-State] of this Agreement.”*** (emphasis added)

This provision suggests that after subrogation, it is the insurer, and not the investor, who has the right to invoke the dispute settlement procedures. The clause explicitly provides that any dispute between the insurer and the host country would need to be settled in accordance with State–State dispute settlement provisions, rather than through investor–State arbitration.

**(vii) Governing law**

Traditionally, some BITs have included a provision indicating the substantive law to be used as the basis for adjudicating a dispute between an investor and the host country. The most common trend, which

has continued to prevail among the BITs reviewed, is to specify that the dispute shall be settled in accordance with the agreement, the applicable principles of international law and, in some cases, the domestic laws of the host country. The BIT between Ethiopia and Sudan (2000) and the BIT between Bulgaria and Thailand (2003) are illustrations of this approach (table 31).

**Table 31. Examples of provisions stating the applicable law in investor–State dispute settlement procedures**

BIT between Ethiopia and Sudan (2000)	BIT between Bulgaria and Thailand (2003)
<p style="text-align: center;">“Article 8 Settlement of Disputes between the Contracting Parties</p> <p>[...]</p> <p>5. The Arbitral Tribunal shall determine its own procedure. The tribunal shall reach its award by a majority of votes in accordance with the provisions of this Agreement and the <b>principles of international law</b> recognized by both Contracting Parties. Such award shall be final and binding on both Contracting Parties. [...]</p> <p>(emphasis added)</p>	<p style="text-align: center;">“Article 9 Settlement of Investment Disputes</p> <p>[...]</p> <p>3. The arbitral tribunal established under this Article shall reach its decision on the basis of <b>national laws</b> and regulations of the Contracting Party, which is a party to the dispute, the provisions of the present Agreement, as well as applicable rules of international law. [...]</p> <p>(emphasis added)</p>

Not all BITs contain a provision indicating what should be the governing law of the dispute. However, at least in those situations where a BIT provides for the application of the ICSID or UNCITRAL arbitration rules those conventions give certain guidance. For instance, article 42(1) of the ICSID Convention stipulates that in the absence of an agreement between the parties with respect to the choice of law, the tribunal shall apply the law of the host country and such rules of international law as may be applicable. Article 33.1 of the UNCITRAL arbitration rules provides that, in the absence of an agreement of the parties, the arbitral tribunal shall apply the law determined by the conflict-of-laws rules which it considers applicable. Furthermore, under article 31 of the Vienna Convention, an agreement such as a BIT would have to be understood “*in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose*”.

#### (viii) Finality and enforcement of arbitral awards

As in the past, most recent BITs state that an arbitral award shall be final and binding for the parties to the dispute. Thus, the conflicting parties are prevented from attempting to resubmit the dispute to another adjudication instance if one of them is dissatisfied with the outcome.

Furthermore, once an arbitral award is issued in investor–State proceedings, the decision will be not only final and binding, but also enforceable. In principle, unless an international convention provides for the recognition and enforcement of an arbitral award made outside its national jurisdiction, a country is under no obligation to recognize and enforce it (UNCTAD, 1998). There are several international conventions that under certain conditions oblige their members to recognize and effectively enforce arbitral awards in their domestic jurisdictions. Two instruments are particularly important, namely the ICSID Convention and the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, signed in New York in 1958, and often referred to as the “New York Convention”.

The ICSID Convention provides the following:

*“Article 54*

- (1) *Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State. A Contracting State with a federal constitution*

- may enforce such an award in or through its federal courts and may provide that such courts shall treat the award as if it were a final judgment of the courts of a constituent state.*
- (2) *A party seeking recognition or enforcement in the territories of a Contracting State shall furnish to a competent court or other authority which such State shall have designated for this purpose a copy of the award certified by the Secretary-General. Each Contracting State shall notify the Secretary-General of the designation of the competent court or other authority for this purpose and of any subsequent change in such designation.*
- (3) *Execution of the award shall be governed by the laws concerning the execution of judgments in force in the State in whose territories such execution is sought.”*

Pursuant to this provision, arbitral awards issued by an ICSID tribunal have binding effect for countries that are parties to that convention. Furthermore, those countries are also obliged to enforce pecuniary obligations imposed by the arbitral decision as if it were a final judgement of a national court. However, the ICSID Convention does not apply to awards made under other arbitration rules. Furthermore, as previously explained, not all BITs refer to the ICSID Convention as a forum for adjudicating an investment dispute, and those doing so often provide the investor with additional options regarding applicable arbitration rules. Not all of these arbitration rules — for instance, the UNCITRAL rules — contain provisions equivalent to article 54 of the ICSID Convention.

It is within this context that the New York Convention becomes particularly relevant. This instrument applies to the recognition and enforcement of arbitral awards made in the territory of a country other than the country where the recognition and enforcement of such awards are sought, as well as to arbitral awards not considered as domestic in the country where their recognition and enforcement are pursued. One of the main provisions of the New York Convention is Article III:

*“Each Contracting State shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon, under the conditions laid down in the following articles. There shall not be imposed substantially more onerous conditions or higher fees or charges on the recognition or enforcement of arbitral awards to which this Convention applies than are imposed on the recognition or enforcement of domestic arbitral awards.”*

Accordingly, countries parties to the New York Convention are obliged to recognize and enforce foreign arbitral awards. However, there are two significant caveats. First, a party may refuse to recognize and enforce a foreign arbitral award in any of the specific situations envisaged in article V of the New York Convention.<sup>145</sup> Second, a party is not obliged to recognize and enforce an arbitral award issued in the territory of another country which has not subscribed to the New York Convention or an award adjudicating a dispute which does not arise out of a legal commercial relationship. In this regard, the New York Convention provides as follows:

*“Article I.*

[...]

3. *When signing, ratifying or acceding to this Convention, or notifying extension under article X hereof, any State may on the basis of reciprocity declare that it will apply the Convention to the recognition and enforcement of awards made only in the territory of another Contracting State. It may also declare that it will apply the Convention only to differences arising out of legal relationships, whether contractual or not, which are considered as commercial under the national law of the State making such declaration.”*

BITs concluded since 1995 have applied different approaches concerning the enforcement of arbitral awards. Taking into consideration the provisions cited above, many BITs have included clauses to prevent the investor–State dispute settlement procedures from having an inoperative result. In particular, BITs within this category usually provide that investor–State arbitration proceedings must take place in a country that is signatory to the New York Convention, and that the claims submitted to arbitration shall be considered to

arise out of a commercial relationship for the purposes of article 1 of that instrument. These agreements not only provide that arbitral awards shall be final, binding and enforceable in the territory of the contracting parties, but also explicitly mandate that arbitration proceedings be held in a country that is a party to the New York Convention (table 32).

**Table 32. Examples of enforcement provisions making reference to the New York Convention**

BIT between Austria and Lebanon (2001)	BIT between Canada and El Salvador (1999)
<p style="text-align: center;">“Article 14 Place of arbitration</p> <p>Any arbitration under this Part shall, at the request of any party to the dispute, be held in a state that is party of the New York Convention. Claims submitted to arbitration under this Part shall be considered to arise out of a commercial relationship or transaction for purposes of Article 1 of the New York Convention.”</p> <p style="text-align: center;">“Article 17 Awards and Enforcement</p> <p>1) Arbitration awards shall be final and binding upon the parties to the dispute. [...] 2) Each Contracting Party shall make provision for the effective enforcement of awards made pursuant to this Article and shall carry out without delay any such award issued in a proceeding to which it is party.”</p>	<p style="text-align: center;">“Article XII: Settlement of Disputes between an Investor and the Host Contracting Party</p> <p>[...] Any arbitration under this Article shall be held in a State that is a party to the New York Convention, and claims submitted to arbitration shall be considered to arise out of a commercial relationship or transaction for the purposes of Article 1 of that Convention. [...] An award of arbitration shall be final and binding and shall be enforceable in the territory of Each of the Contracting Parties. ”</p>

However, not all BITs examined have included detailed dispute settlement provisions. Those BITs containing general provisions on investor–State dispute settlement usually provide only that the contracting parties have to comply with and enforce arbitral awards in their territories in accordance with their own laws and regulations. A case in point is the BIT between Japan and the Republic of Korea (2002):

*“Article 15*

[...]

6. *Any arbitral award rendered pursuant to this Article shall be final and binding on the parties to the dispute. Each Contracting Party shall carry out without delay the provisions of any such award and provide in its territory for the enforcement of such award in accordance with its relevant laws and regulations. [...]*”

Under this approach, BITs do not deal with the specific aspects ensuring that an arbitral award be effectively recognized and enforced under the jurisdiction of the contracting party concerned. Rather, it would be for the contracting party to decide how to execute these awards. However, as previously explained, the recognition and enforcement of an arbitral award under national jurisdiction may be a complex matter.

This method is based on the assumption that the contracting parties will take all necessary steps within their legislations to comply with the obligation to enforce international arbitral awards. If this is not the case, the only other avenue for an investor would be to seek diplomatic protection and ask its home country to submit a claim under the State–State dispute settlement provisions of the BIT.

**(ix) Espousal of disputes submitted to investor–State arbitration**

As previously explained, one of the strategic advantages of investor–State dispute settlement mechanisms for developing countries — in addition to increasing certainty — is that it avoids a political

interplay in the resolution of an investment conflict. As an impartial judicial body decides the dispute, the contracting party of which the investor is a national is, in principle, prevented from exercising diplomatic protection.<sup>146</sup>

Taking this aspect into consideration, and to avoid any possibility of reopening the dispute if an investor is not satisfied, most recent BITs have included specific provisions on this issue. Following an already existing trend, many BITs explicitly prohibit the contracting parties from exercising diplomatic protection in favour of their investors once the latter have submitted their claims under investor–State arbitration procedures.<sup>147</sup> The BIT between Australia and India (1999) is an example:

*“Article 12*

*Settlement of disputes between an investor and a Contracting Party*

[...]

4. *Once an action referred to in paragraphs 2 [submission of the dispute to local courts or to conciliation] and 3 [international arbitration] of this article has been taken, neither Contracting Party shall pursue the dispute through diplomatic channels unless:*
- (a) the relevant judicial or administrative body, the Secretary General of the Centre, the arbitral authority or tribunal or the conciliation commission, as the case may be, has decided that it has no jurisdiction in relation to the dispute in question;*
  - (b) the other Contracting Party has failed to abide by or comply with any judgement, award, order or other determination made by the body in question.”*

Under this approach, once an investment dispute is submitted to international arbitration, the only two cases in which a contracting party could exercise diplomatic protection are where the arbitration tribunal lacked the jurisdiction to adjudicate the dispute or where the contracting party involved in the dispute does not comply with the arbitral award.

## **b. Innovations in investor–State dispute settlement provisions**

An increasing number of BITs has started to innovate investor–State dispute settlement procedures. Where once only a few paragraphs were devoted to this issue, some agreements now regulate the proceedings in greater detail, in some cases dedicating a whole section to them. This is the case of some BITs of Austria, Canada, Mexico and the United States.<sup>148</sup>

These developments have made investor–State dispute settlement procedures one of the key areas where significant innovations in treaty-making have taken place over the review period. Recent BITs have incorporated various novel provisions aimed at fostering the following objectives: to provide greater predictability and contracting parties’ control over arbitration procedures; to promote the principle of judicial economy in investment-related disputes; to ensure consistency among arbitral awards and the development of sound jurisprudence on international investment law; and to promote the overall legitimacy of investor–State arbitration.

### **(i) Promotion of greater predictability and contracting parties’ control over arbitration procedures**

As previously indicated, some innovations in investor–State dispute settlement included in several BITs under review are geared towards greater predictability and control by the contracting parties over arbitration procedures. This objective has been pursued through different techniques.

One of these concerns the drafting stage. Some contracting parties no longer refer only to a set of existing arbitration rules, such as those of ICSID, the ICC or UNCITRAL, for the purposes of determining investor–State dispute settlement procedures. Recent BITs have started to specify a series of matters related to the arbitral proceedings, which other BITs often leave undetermined or subject to the agreement between the disputing parties on a case-by-case basis.

The most elaborate provisions on investor–State arbitration can be found in the NAFTA, and in some recent BITs following the NAFTA model. For the first time, the NAFTA's investment chapter addressed a number of issues on which BITs are often silent, such as the procedures to apply when submitting a notice of intent for arbitration, how to prevent the same dispute from being simultaneously taken up in more than one legal forum, specific procedures for the appointment of arbitrators and expert review groups, specification of the place of arbitration, measures for interim injunctive relief, preliminary objections, conduct of arbitral proceedings and enforcement of awards. Through these regulations contracting parties increase predictability and control over the execution of arbitration procedures.

Another means to that end relates to the implementation of these mechanisms. Recent BITs, such as the one between the United States and Uruguay (2005) and the 2004 Canadian model BIT, include provisions ensuring the involvement of both contracting parties in arbitration proceedings by addressing certain subject matters, such as financial services, taxation or the interpretation of a non-conforming measure. In all these instances, BITs provide for the possibility for specialized authorities of the contracting parties to interpret certain matters or provisions of the agreement, which shall be binding for the arbitration tribunal.

For instance, paragraphs 1 and 2 of article 17 of the 2004 Canadian model BIT provide that where an investor submits a claim to arbitration related to financial services, and the disputing contracting party, as a defence, invokes the general exception based on prudential reasons included in articles 10(2) or 14(6) of the agreement, the arbitral tribunal:

*“[...] shall, at the request of that Party, seek a report in writing from the Parties on the issue of whether and to what extent the said paragraphs are a valid defence to the claim of the investor. The tribunal may not proceed pending receipt of a report under this Article [...] The Parties shall proceed [...] to prepare a written report, either on the basis of agreement following consultations, or by means of an arbitral panel. The consultations shall be between the financial services authorities of the Parties. The report shall be transmitted to the Tribunal, and shall be binding on the Tribunal.”*

This mechanism leaves — at least in the first instance — to the competent authorities of the contracting parties, and not to arbitral tribunals, the decision whether a claim brought by an investor should be rejected on the grounds of an exception for prudential reasons.

Another example of the inclusion of a control mechanism is found in the BIT between the United States and Uruguay (2005):

*“Article 21: Taxation*

*[...]*

3. *Article 6 [Expropriation] shall apply to all taxation measures, except that a claimant that asserts that a taxation measure involves an expropriation may submit a claim to arbitration under Section B [investor-State dispute settlement] only if:*
  - (a) the claimant has first referred to the competent tax authorities of both Parties in writing the issue of whether that taxation measure involves an expropriation; and*
  - (b) within 180 days after the date of such referral, the competent tax authorities of both Parties fail to agree that the taxation measure is not an expropriation.”* (text in brackets added)

This provision allows the competent tax authorities of both contracting parties to decide whether a particular taxation measure is in fact an expropriation. If the authorities agree that this is not the case, the investor is prevented from submitting a claim under the investor–State dispute settlement provisions. This mechanism aims at ensuring that the decision as to whether a tax measure is an expropriation is primarily left to the competent tax authorities of the contracting parties, and not to arbitral tribunals.

A third illustration of this trend is another mechanism provided for in the BIT between the United States and Uruguay (2005):

*“Article 31: Interpretation of Annexes*

1. *Where a respondent asserts as a defense that the measure alleged to be a breach is within the scope of an entry set out in Annex I, [Non-conforming measures] II [Future measures], or III [Non-conforming measures in financial services], the tribunal shall, on request of the respondent, request the interpretation of the Parties on the issue. The Parties shall submit in writing any joint decision declaring their interpretation to the tribunal within 60 days of delivery of the request.*
2. *A joint decision issued under paragraph 1 by the Parties, each acting through its representative designated for purposes of this Article, shall be binding on the tribunal, and any decision or award issued by the tribunal must be consistent with that joint decision. If the Parties fail to issue such a decision within 60 days, the tribunal shall decide the issue”* (text in brackets added).

Once more, this mechanism reserves the prerogative to interpret the content and scope of the annexes of non-conforming measures and future measures to the contracting parties, and not to arbitral tribunals. Only if the contracting parties cannot reach a joint decision is an arbitral tribunal allowed to give its own interpretation.

**(ii) Promotion of judicial economy**

Among the BITs of the last decade, a second set of innovations in investor–State arbitration is geared towards promoting the principle of judicial economy. Several novelties included in recent BITs illustrate this trend. One is a provision dealing with potential “frivolous claims” submitted by an investor. A second mechanism seeks to prevent a particular investment dispute from being dealt with in more than one adjudication forum. Another innovation is the possibility of consolidating separate claims that have a question of law or fact in common, and arise out of the same events or circumstances.

*1. Mechanism to avoid “frivolous claims”*

The significant increase in investor–State disputes has raised concerns that investors might abuse the system.<sup>149</sup> As this may occur in domestic litigation when submitting a dispute to arbitration, investors may think that the greater the number of claims, the better the chance of having the arbitral tribunal adjudicating at least one in their favour. This can take a heavy toll in terms of time, effort, fees and other costs, not only for the defendant contracting party but also for the arbitral tribunal.

Several countries have advocated the inclusion of a procedure to avoid “frivolous claims” in investment-related disputes, i.e. claims that evidently lack a sound legal basis. Accordingly, an arbitration tribunal shall address and decide, as a preliminary question, any objection by the respondent that, as a matter of law, the claim is not one for which an award in favour of the claimant may be made. In deciding an objection under this procedure, the arbitration tribunal shall assume that the claimant’s factual allegations in support of the claims are true, and shall issue a decision or award on the objection on an expedited basis. The BIT between the United States and Uruguay (2005) demonstrates this approach, which has also been included in the investment chapters of several recent free trade agreements of the United States.

*“Article 28 Conduct of the Arbitration*

[...]

4. *Without prejudice to a tribunal’s authority to address other objections as a preliminary question, a tribunal shall address and decide as a preliminary question any objection by the respondent that, as a matter of law, a claim submitted is not a claim for which an award in favour of the claimant may be made under Article 34.*

- (a) *Such objection shall be submitted to the tribunal as soon as possible after the tribunal is constituted, and in no event later than the date the tribunal fixes for the respondent to submit its counter-memorial (or, in the case of an amendment to the notice of arbitration, the date the tribunal fixes for the respondent to submit its response to the amendment).*
  - (b) *On receipt of an objection under this paragraph, the tribunal shall suspend any proceedings on the merits, establish a schedule for considering the objection consistent with any schedule it has established for considering any other preliminary question, and issue a decision or award on the objection, stating the grounds therefore.*
  - (c) *In deciding an objection under this paragraph, the tribunal shall assume to be true claimant's factual allegations in support of any claim in the notice of arbitration (or any amendment thereof) and, in disputes brought under the UNCITRAL Arbitration Rules, the statement of claim referred to in Article 18 of the UNCITRAL Arbitration Rules. The tribunal may also consider any relevant facts not in dispute.*
  - (d) *The respondent does not waive any objection as to competence or any argument on the merits merely because the respondent did or did not raise an objection under this paragraph or make use of the expedited procedure set out in paragraph 5.*
5. *In the event that the respondent so requests within 45 days after the tribunal is constituted, the tribunal shall decide on an expedited basis an objection under paragraph 4 and any objection that the dispute is not within the tribunal's competence. The tribunal shall suspend any proceedings on the merits and issue a decision or award on the objection(s), stating the grounds therefore, no later than 150 days after the date of the request. However, if a disputing party requests a hearing, the tribunal may take an additional 30 days to issue the decision or award. Regardless of whether a hearing is requested, a tribunal may, on a showing of extraordinary cause, delay issuing its decision or award by an additional brief period, which may not exceed 30 days."*

The objective of an expedited procedure included in this provision is to avoid spending time and resources on adjudicating claims that lack a sound legal foundation. This intention is also evidenced by the specific time frames provided in paragraph 5 of article 28 above.

## 2. *Limitation to one arbitration forum*

Some treaties provide that if an investor chooses to submit a claim to domestic courts, that decision extinguishes the right to arbitration, and vice versa. This is known as a "fork in the road" provision. The BIT between Chile and Egypt (1999) demonstrates that approach:

### *"Article 8*

#### *Settlement of disputes between a Contracting Party and an investor of the other Contracting Party*

[...]

- 3) *Once the investor has submitted the dispute to the competent tribunal of the Contracting Party in whose territory the investment was made or to international arbitration, that election shall be final. [...]"*

That article compels the investor to make a decision *ab initio* as to whether to pursue the adjudication of the dispute in domestic courts or to invoke international arbitration. This method shows that, in addition to conceiving international arbitration as an alternative means of dispute resolution, judicial economy is another reason for contracting parties to abstain from requesting exhaustion of local remedies.<sup>150</sup>

Other BITs provide the investor with the possibility of deciding upon the venue for resolving the dispute at a later stage, even after it has been submitted to the administrative or judicial tribunals of the host country. BITs applying this method allow the investor to opt for international arbitration as long as domestic tribunals have not made a final award. Article XIII.3 of the BIT between Canada and Thailand (1997) is illustrative of that method. It provides that an investor may submit a dispute to arbitration only if "[...] *the investor has waived to initiate or continue any other proceedings in relation to the measure that is alleged to*



*be in breach of this Agreement before the courts or tribunals of the Contracting Party concerned or in a dispute settlement procedure of any kind*".

This approach — known as the “no-U-turn” — also forecloses another situation in which the same dispute could be submitted to multiple forums. This would be the case if an investor first submitted the dispute to arbitration and, depending on the outcome, then opted to present it to local courts.

### 3. Consolidation of claims

Another mechanism included in some BITs to foster judicial economy and to avoid inconsistent results is to allow the consolidation of claims having a question of law or fact in common, and/or arising out of the same events or circumstances. Most BITs concluded by Mexico since 1995, as well as the recent BITs of the United States and the 2004 Canadian model BIT, authorize the formation of a special tribunal to exercise jurisdiction over claims that have the above-mentioned features. The BIT between Greece and Mexico (2000) is a case in point:

#### *“Article 13 Consolidation*

1. *A tribunal of consolidation established under this Article shall be installed under the UNCITRAL Arbitration Rules and shall conduct its proceedings in accordance with those Rules, except as modified by this Part.*
2. *Proceedings will be consolidated in the following cases:*
  - a) *when an investor submits a claim to arbitration on behalf of a legal person that is his investment and, simultaneously, another investor or other investors participating in the same legal person, submit claims on their own behalf as a consequence of the same breaches of this Agreement; or*
  - b) *when two or more claims are submitted to arbitration arising from common legal and factual issues.*
3. *The tribunal of consolidation will decide the jurisdiction of the claims and will jointly review such claims, unless an investor asserts that his interests are seriously harmed.”*

#### **(iii) Promotion of consistent and sound jurisprudence on international investment law**

A third category of innovations is geared towards ensuring a consistent and correct application of international law in arbitral awards. As previously explained, more recent BITs have been concluded against the background of a substantial increase in investor–State disputes. The latter have yielded awards that have not always been consistent. Some recent BITs have therefore included provisions to foster a consistent and sound development of the jurisprudence.

A number of BITs include more detailed provisions on several key substantive issues the interpretation of which has been controversial in arbitration proceedings. For example, as was explained in sections E and F of this study, Canada and the United States have recently modified their BITs to clarify the meaning of “fair and equitable treatment” and the concept of indirect expropriation.

It has also been suggested that arbitrations be subject to appeal. For instance, the BIT between the United States and Uruguay (2005) provides that within three years after the entry into force of the agreement, the parties shall consider whether to establish a bilateral appellate body to review awards. In particular, an annex to that treaty provides the following:

*“Annex E  
Possibility of a Bilateral Appellate Mechanism*

*Within three years after the date of entry into force of this Treaty, the Parties shall consider whether to establish a bilateral appellate body or similar mechanism to review awards rendered under Article 34 in arbitrations commenced after they establish the appellate body or similar mechanism.”*

The possibility of establishing an appellate mechanism for arbitral awards has also been envisaged in other recent investment-related agreements of the United States, such as the Free Trade Agreement between Chile and the United States (2003) and the Free Trade Agreement concluded by the Central American countries, the United States and the Dominican Republic (DR-CAFTA) (2004).<sup>151</sup>

These appellate mechanisms raise many issues. There is still no clarity regarding the particular features that such an appeal mechanism would have, nor about how it would interact with the existing arbitration conventions or other BITs of the parties concerned. Furthermore, if the main purpose of an appellate mechanism is to ensure consistency in arbitral awards, it should bring under its umbrella most, if not all, existing BITs and other IIAs. However, such an outcome could not be achieved by an appellate mechanism established by only one or several bilateral agreements.

**(iv) Promotion of legitimacy of investor–State arbitration**

Another novelty that has emerged in recent BITs is geared towards promoting the overall legitimacy of investor–State arbitration. One concern relates to the limited transparency of these proceedings. In response, the 2004 Canadian model BIT and recent BITs of the United States include provisions fostering the transparency of arbitration proceedings.

For instance, article 29 of the BIT between the United States and Uruguay (2005) requires the respondent to transmit certain documents to the home country and to make them available to the public, including the notice of arbitration, the memorials, the transcripts of hearings and the arbitral awards. Similarly, the 2004 Canadian model BIT also requires that the hearings be open to the public, although provisions are made for the protection of confidential business information. However, these rules do not require the parties to make public any negotiations on the settlement of the dispute, nor do they interfere with the confidentiality of the tribunal’s deliberations. The 2004 Canadian model BIT states:

*“Article 38  
Public Access to Hearings and Documents*

1. *Hearings held under this Section shall be open to the public. To the extent necessary to ensure the protection of confidential information, including business confidential information, the Tribunal may hold portions of hearings in camera.*
2. *The Tribunal shall establish procedures for the protection of confidential information and appropriate logistical arrangements for open hearings, in consultation with the disputing parties.*
3. *All documents submitted to, or issued by, the Tribunal shall be publicly available, unless the disputing parties otherwise agree, subject to the deletion of confidential information.*
4. *Notwithstanding paragraph 3, any Tribunal award under this Section shall be publicly available, subject to the deletion of confidential information.*
5. *A disputing party may disclose to other persons in connection with the arbitral proceedings such unredacted documents as it considers necessary for the preparation of its case, but it shall ensure that those persons protect the confidential information in such documents.*
6. *The Parties may share with officials of their respective federal and sub-national governments all relevant unredacted documents in the course of dispute settlement under this Agreement, but they shall ensure that those persons protect any confidential information in such documents.*
7. *As provided under Article 10(4) and (5), the Tribunal shall not require a Party to furnish or allow access to information the disclosure of which would impede law enforcement or would be contrary to the Party’s law protecting Cabinet confidences, personal privacy or the financial*

*affairs and accounts of individual customers of financial institutions, or which it determines to be contrary to its essential security.*

8. *To the extent that a Tribunal's confidentiality order designates information as confidential and a Party's law on access to information requires public access to that information, the Party's law on access to information shall prevail. However, a Party should endeavour to apply its law on access to information so as to protect information designated confidential by the Tribunal."*

The trend towards fostering transparency in investor–State dispute settlement goes beyond allowing the public to be informed about the different stages of the proceedings. The 2004 Canadian model BIT and recent BITs of the United States also allow parties not involved in the dispute to submit briefs and to authorize arbitral tribunals to consider submissions from any member of civil society. As a result, these agreements stipulate in detail the procedures under which such *amicus curiae* briefs are to be submitted and administered, intending to prevent them from negatively affecting the normal conduct of the arbitration. This explains, for instance, the screening mechanism included in article 39 of the 2004 Canadian model BIT, which provides for certain criteria under which the arbitral tribunal has to decide on whether a non-disputing party may file a submission, and, if the authorization is granted, provides guidance as to the weight that such submission should have in the proceedings. In its relevant parts, the article states as follows:

*"Article 39*

*Submissions by a Non-Disputing Party*

1. *Any non-disputing party that is a person of a Party, or has a significant presence in the territory of a Party, that wishes to file a written submission with a Tribunal (the "applicant") shall apply for leave from the Tribunal to file such a submission [...].*
2. *The applicant shall serve the application for leave to file a non-disputing party submission and the submission on all disputing parties and the Tribunal.*
3. *The Tribunal shall set an appropriate date for the disputing parties to comment on the application for leave to file a non-disputing party submission.*
4. *In determining whether to grant leave to file a non-disputing party submission, the Tribunal shall consider, among other things, the extent to which:*
  - (a) *the non-disputing party submission would assist the Tribunal in the determination of a factual or legal issue related to the arbitration by bringing a perspective, particular knowledge or insight that is different from that of the disputing parties;*
  - (b) *the non-disputing party submission would address a matter within the scope of the dispute;*
  - (c) *the non-disputing party has a significant interest in the arbitration; and*
  - (d) *there is a public interest in the subject-matter of the arbitration.*
5. *The Tribunal shall ensure that:*
  - (a) *any non-disputing party submission does not disrupt the proceedings; and*
  - (b) *neither disputing party is unduly burdened or unfairly prejudiced by such submissions.*
6. *The Tribunal shall decide whether to grant leave to file a non-disputing party submission. If leave to file a non-disputing party submission is granted, the Tribunal shall set an appropriate date for the disputing parties to respond in writing to the non-disputing party submission. By that date, the non-disputing Party may, pursuant to Article 34 (Participation by the Non-Disputing Party), address any issues of interpretation of this Agreement presented in the non-disputing party submission.*
7. *The Tribunal that grants leave to file a non-disputing party submission is not required to address the submission at any point in the arbitration, nor is the non-disputing party that files the submission entitled to make further submissions in the arbitration. [...]"*

This approach demonstrates that transparency provisions serve important goals; however, they may also increase the burden on the disputing parties and limit their discretion. For example, parties may feel the need to submit additional materials for responding to arguments made in the *amicus curiae* briefs. Public knowledge of the disputes may result in pressure on the parties to settle or to refuse to settle the dispute. This may undermine one of the main objectives of investor–State dispute settlement: to foster a rule-oriented

adjudication mechanism, where politics interfere as little as possible with the development of a sound international legal investment regime.

## 2. State–State dispute resolution

Unlike investor–State dispute settlement, an area where several significant developments in treaty-making have taken place, State–State dispute settlement reveals a much lesser degree of innovation in recent BITs.

Also, there is a higher degree of generality, a feature that contrasts not only with investor–State dispute settlement provisions, but also with State–State arbitration rules in trade agreements. In the trade field, State–State dispute settlement has become one of the most sophisticated areas of international rulemaking, not only in the WTO, where the Dispute Settlement Understanding (DSU) constitutes one of the main innovations of the multilateral trading system after the Uruguay Round, but also in the context of new regional trade agreements, which include dispute settlement mechanisms inspired by the DSU. In sharp contrast, BITs have continued with the traditional approach of devoting one single provision to State–State dispute settlement.

### a. Traditional features in State–State dispute settlement provisions

Provisions in BITs regulating this subject are typically very short and deal with the following main issues: the scope of application of the procedures; the obligation of the parties to consult prior to the establishment of an arbitral tribunal; the appointment of the arbitrators; the arbitral procedures; and the costs of the arbitration (UNCTAD 2003c).

Most treaties provide that the State–State dispute settlement provisions shall apply to disputes between the contracting parties concerning the interpretation or application of the BIT. Furthermore, before invoking formal arbitration proceedings, practically all BITs mandate the contracting parties to attempt to settle the dispute by consultations or negotiations. The BIT between Cambodia and Cuba (2001) is an illustration:

*“Article IX  
Settlement of disputes between the Contracting Parties concerning interpretation and  
application of the Agreement*

1. *Disputes between the Contracting Parties concerning the interpretation and application of the Agreement should, if possible, be settled through diplomatic channels. [...]*”

Most BITs prescribe a period of six months for holding consultations, although some agreements set shorter periods, and some do not cover this issue at all.<sup>152</sup>

Unlike investor–State dispute settlement mechanisms, provisions on State–State arbitration have continued with the traditional approach of establishing an ad hoc arbitration procedure, that is a tribunal specifically constituted for the dispute involved, rather than arbitration before an existing institution (UNCTAD 1998).

The usual procedure included in BITs is for each contracting party to select one arbitrator, and then authorize the two to select a third arbitrator, who usually shall not be a national of any of the contracting parties and who shall serve as the chair of the tribunal. If the appointments are not made within the agreed time frames, or if arbitrators cannot agree on the chair of the tribunal, practically all BITs provide that a third instance shall act as appointment authority. Often, this is the President or Vice-President of the International Court of Justice. The BIT between Australia and India (1999) typifies this approach:

*“Article 13  
Disputes between the Contracting Parties*

[...]

3. *Such an arbitral tribunal shall be constituted for each individual case in the following way. Within two months of the receipt of the request for arbitration, each Contracting Party shall appoint one member of the tribunal. Those two members shall then select a national of a third State who on approval by the two Contracting Parties shall be appointed Chairperson of the tribunal. The Chairperson shall be appointed within one month from the date of appointment of the other two members.*
4. *If within the periods specified in paragraph 3 of this Article the necessary appointments have not been made, either Contracting Party may, in the absence of any other agreement, invite the President of the International Court of Justice to make any necessary appointments. If the President is a national of either Contracting Party or if he is otherwise prevented from discharging the said function, the Vice-President shall be invited to make the necessary appointments. If the Vice-President is a national of either Contracting Party or if he too is prevented from discharging the said function, the Member of the International Court of Justice next in seniority who is not a national of either Contracting Party shall be invited to make the necessary. [...]*”

Some BITs, however, delegate the appointing authority to the Secretary-General of ICSID.<sup>153</sup>

A number of BITs provide that the UNICTRAL arbitration rules shall govern the procedure unless the contracting parties agree otherwise.<sup>154</sup> Other treaties authorize the tribunal to determine its own procedure. Most BITs also state that decisions of the tribunal have to be taken by majority vote. The tribunal has to decide the case on the basis of the BIT, although some agreements also envisage the possibility of the tribunal’s taking into account the law of the host country and, exceptionally, provide for the possibility of deciding *ex aequo et bono* if the contracting parties so wish.<sup>155</sup> Furthermore, the BITs usually specify that all awards shall be final and binding.

Most BITs address the costs of State–State dispute settlement. Usually, they provide that such costs shall be divided among the contracting parties. Thus, each contracting party bears the cost of its own representation before the tribunal and the arbitrator whom it appoints. The remaining costs are divided among the contracting parties. An example is the BIT between Hungary and Lebanon (2001):

*“Article 9  
Settlement of Disputes between the Contracting Parties*

[...]

5. *The Arbitral Tribunal shall reach its decision by a majority of votes.*
6. *The Tribunal shall issue its decision on the basis of respect for the law, the provisions of this Agreement, as well as of the universally accepted principles of international law.*
7. *Subject to other provisions made by the Contracting Parties, the Tribunal shall determine its procedure.*
8. *Each Contracting Party shall bear the cost of its own arbitrator and its representation in the arbitral proceedings; the cost of the Chairman and the remaining costs shall be borne in equal parts by both Contracting Parties. The Arbitral Tribunal may make a different regulation concerning the costs.*
9. *The decisions of the Tribunal are final and binding for each Contracting Parties.”*

**b. Main innovations in State–State dispute settlement provisions**

As mentioned before, in comparison with the innovations in investor–State dispute settlement, the novelties in State–State arbitration have been much more modest. Nonetheless, some BITs under review do

include innovative features that might become important precedents for the future. Three novelties are worth mentioning.

### (i) Transparency in arbitral proceedings

Following the trend in investor–State dispute settlement, recent BITs of the United States include provisions aimed at fostering greater transparency and participation of civil society in State–State arbitration. For example, pursuant to article 37.4 of the BIT between the United States and Uruguay (2005), most transparency obligations in investor–State arbitration are also applicable to State–State proceedings.<sup>156</sup> Consequently, this BIT requires the contracting parties to make available to the public certain documents, including the notice of arbitration, the memorials, the transcripts of hearings and the arbitral awards. Furthermore, the BIT between the United States and Uruguay (2005) requires that the hearings be open to the public, although provisions are made for the protection of confidential business information, and allows the tribunal to accept *amicus curiae* submissions.

Not all countries that have recently included transparency obligations in investor–State dispute settlement have also done so with regard to State–State procedures. This might suggest that the pressure for fostering the legitimacy of State–State arbitration does not have the same intensity as in the case of investor–State dispute settlement.

### (ii) Special provisions for disputes on financial services

Another innovation relates to financial services. As mentioned previously, financial services are usually heavily regulated and subject to close supervisory control by specialized governmental authorities. Thus, recent BITs of Canada and the United States ensure that in disputes involving financial services the members of the tribunal have particular expertise in this field (table 33).

**Table 33. Examples of provisions requiring special qualifications for arbitrators in disputes involving financial services**

BIT between the United States and Uruguay (2005)	2004 Canadian model BIT
<p style="text-align: center;">“Article 20 Financial Services</p> <p>[...] 5. Where a Party submits a dispute involving financial services to arbitration under Section C [State-State Dispute Settlement] in conformance with paragraph 4, and on the request of either Party within 30 days of the date the dispute is submitted to arbitration, each Party shall, in the appointment of all arbitrators not yet appointed, take appropriate steps to ensure that the tribunal has expertise or experience in financial services law or practice. The expertise of particular candidates with respect to financial services shall be taken into account in the appointment of the presiding arbitrator. [...].”</p>	<p style="text-align: center;">“Article 48 Disputes between the Parties</p> <p>[...] 6. Where a Party claims that a dispute involves measures relating to financial institutions, or to investors or investments of such investors in financial institutions, then (a) where the disputing Parties are in agreement, the arbitrators shall, in addition to the criteria set out in paragraph 5, have expertise or experience in financial services law or practice, which may include the regulation of financial institutions; or (b) where the disputing Parties are not in agreement, (i) each disputing Party may select arbitrators who meet the qualifications set out in subparagraph (a), and (ii) if the Party complained against invokes Articles 14(6) or 17 [Exception for Prudential Reasons ], the chair of the panel shall meet the qualifications set out in subparagraph (a). [...].”</p>

In addition to requiring special qualifications for arbitrators dealing with financial services, the BIT between the United States and Uruguay (2005) provides that the competent financial authorities of both contracting parties shall hold consultations prior to the initiation of any adjudication proceeding. In particular, the treaty states as follows:

*“Article 20: Financial Services*

[...]

4. *Where a dispute arises under Section C [State-State dispute settlement] and the competent financial authorities of one Party provide written notice to the competent financial authorities of the other Party that the dispute involves financial services, Section C shall apply except as modified by this paragraph and paragraph 5.*
- (a) *The competent financial authorities of both Parties shall make themselves available for consultations with each other regarding the dispute, and shall have 180 days from the date such notice is received to transmit a report on their consultations to the Parties. A Party may submit the dispute to arbitration under Section C only on the expiration of that 180-day period.*
- (b) *Either Party may make any such report available to a tribunal constituted under Section C to decide the dispute referred to in this paragraph or a similar dispute, or to a tribunal constituted under Section B [investor-State dispute settlement] to decide a claim arising out of the same events or circumstances that gave rise to the dispute under Section C.”*

The purpose of this mechanism is to provide an opportunity for the competent financial authorities of the contracting parties to attempt to reach an agreement before submitting a dispute to settlement. It also seeks to ensure that if the contracting parties cannot reach a solution on the basis of their expertise, these authorities produce a report that can serve as guidance for an arbitral tribunal.

**(iii) Enforcement measures**

A third novelty concerns the enforcement of arbitral awards. As explained in subsection L.2.a above, most BITs provide that the decision of the arbitral tribunal in State-State proceedings shall be final and binding for the contracting parties. However, unlike the situation in trade agreements, most BITs do not contain provisions dealing with the case where a contracting party fails to comply with an arbitral award. Exceptions are the Canadian BITs, which include measures that a contracting party may take if the other contracting party fails to comply with the decision. The BIT between Canada and Thailand (1997) is a case in point:

*“Article XV**Disputes between the Contracting Parties*

[...]

- (7) *The Contracting Parties shall, within 60 days of the decision of a tribunal, reach agreement on the matter in which to resolve their dispute. Such agreement shall normally implement the decision of the tribunal. Such agreement shall also be considered part of the arbitral tribunal’s decision. If the Contracting Parties fail to reach agreement, the Contracting Party bringing the dispute shall be entitled to compensation or to suspend benefits of equivalent value to those awarded by the panel.”*

Although this article provides for negotiations between the contracting parties even after an arbitral decision has been rendered, the prevailing party will presumably have greater leverage to obtain an agreement complying with the final arbitral award. Furthermore, if a contracting party fails to comply with the arbitral decision, the article provides for compensation or suspension of benefits of a value equivalent to those awarded by the panel.

There is the issue of which benefits could be suspended in accordance with this clause. Would it be only those granted to the other contracting party as a result of the BIT? Or could a party suspend any kind of benefits? Could the prevailing contracting party suspend benefits accrued to the other by virtue of another agreement? There is no significant jurisprudence to answer these questions. However, in principle, a contracting party would be free to choose the means by which to suspend the benefits, provided that it did not violate any other obligation in other international agreements to which the parties in dispute are members.

The experience with State–State dispute settlement is much more limited than in the case of investor–State disputes. What does this mean in terms of the role these dispute settlement provisions play from the perspective of international economic governance?

A plausible hypothesis would be that investor–State dispute settlement, and not State–State arbitration, constitutes the main avenue through which compliance with BITs is sought and ensured. The limited — not to say scant — use of State–State dispute settlement may explain why its treatment in most BITs continues to be of a general nature.

\* \* \*

In conclusion, some of the most important innovations in BITs concluded during the review period have been with regard to dispute settlement. Departing from the traditional approach of outlining in the BIT only the main features of the dispute settlement procedures, some recent agreements address the issue in much more detail. By providing more guidance to the disputing parties and the arbitration tribunal, these BITs intend to strengthen the rule of law and to make the outcome of investor–State disputes more predictable. Several means have been used for this purpose, including the involvement of experts, provisions for the consolidation of claims and third-party participation. By contrast, State–State dispute settlement procedures have basically remained unchanged.

### Notes

<sup>1</sup> Article 31 of the Vienna Convention states:

*“1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.*

*2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes: [...]”*

<sup>2</sup> As will be explained below, even those agreements that include a specific clause on scope of application still rely on the definitions of the terms “investment” and “investor” as a means to delimit the subject matter to which the BIT applies.

<sup>3</sup> Increasing experience in the use of investor–State dispute settlement mechanisms during the last decade demonstrates how important it is to clearly delimit the scope of application of the BITs for the purpose of determining whether a particular dispute falls within the jurisdiction of arbitral tribunals. See NAFTA and other ICSID cases for decisions on jurisdiction (<http://www.worldbank.org/icsid/cases/cases.htm>). Also, for further information on the increase in the use of investor–State investment arbitration, see UNCTAD (2005b).

<sup>4</sup> Such provisions were interpreted in the arbitration cases *Yaung Chi Oo Trading Pte Ltd. v. Government of the Union of Myanmar*, ASEAN Case No. ARB/01/1 (31 March 31), ASEAN Arbitral Tribunal (ICSID Additional Facility Rules) and *Philippe Gruslin v. Malaysia* (ICSID Case No. ARB/94/1).

<sup>5</sup> This point is developed in VanDuzer (2002) and Dawson (2002).

<sup>6</sup> *Pope & Talbot, Inc. v. The Government of Canada*, UNCITRAL, Interim Award on Merits of 26 June 2000; *S.D. Myers, Inc. v. Canada*, UNCITRAL, First Partial Award of 13 November 2000 (NAFTA). See also *Joy Mining Machinery Limited v. Egypt*, ICSID Case No. ARB/03/11, Decision on Jurisdiction of 6 August 2004.

<sup>7</sup> In this regard, see *Canada – Certain Measures Concerning Periodicals* (WT/DS31/AB/R, 30 July 1997), and *European Communities – Regime for the Importation, Sale and Distribution of Bananas* (WT/DS27/AB/R, 25 September 1997).

<sup>8</sup> *SGS Société de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of 16 October 2002; *SGS Société de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of 29 January 2004.

<sup>9</sup> “An initial choice facing BIT negotiators is whether to define the term “investment” at all. The concern about defining the term obviously is that new forms of investment, the protection of which is consistent with United States foreign investment policy, may be excluded from BIT protection simply because the drafters failed to anticipate their creation. Leaving the term undefined permits it to evolve along with the changing nature of circumstances, but creates a risk that an arbitral tribunal might construe it narrowly” (Vandevelde, 1992).

<sup>10</sup> The definition of “investment” in this BIT leaves for a case-by-case determination the decision as to whether a particular debt instrument is a covered investment for the purposes of the agreement. In this regard, the definition contains a footnote that states:

*“Some forms of debt, such as bonds, debentures, and long-term notes, are more likely to have the characteristics of an investment, while other forms of debt, such as a bank account that does not have a*



*commercial purpose and is related neither to an investment in the territory in which the bank account is located nor to an attempt to make such an investment, are less likely to have such characteristics.”*

<sup>11</sup> And also in the recent 2004 Canadian Model BIT, see subsection (iii) above.

<sup>12</sup> That was the case of the BITs between Germany and Israel (article I(3)(b)), concluded in 1976, and between Denmark and Indonesia (article I (a)) concluded in 1968.

<sup>13</sup> Dual nationality has been a particular issue in cases before the Iran–United States Claims Tribunal. See, for example, *The Islamic Republic of Iran v. The United States of America, Case No. A/18 (Apr. 6, 1984)*. The Iran–United States Claims Tribunal found that it has jurisdiction over claims against the Islamic Republic of Iran by dual Iran–United States nationals when the dominant and effective nationality of the claimant was that of the United States.

<sup>14</sup> As explained in UNCTAD (1999a), while the place of incorporation is the easiest criterion to determine, it has the caveat that the country where the company is organized may have no other connection with the company. Indeed, it may well be the case that nationals of a non-party to the agreement could constitute an enterprise under the laws of a contracting party simply to gain treaty protection. Bearing in mind this potential problem, BITs using the place of incorporation as the sole criterion to ascribe nationality to a legal entity also include a denial of benefits clause. Such a provision is designed to allow the party concerned to deny treaty protection to a company that is incorporated under the laws of the other party when the company is controlled by nationals of a non-party or when the company does not have substantial business activities in the territory of the other contracting party. The denial of benefits clause is explained in more detail in Section I below.

Ownership or control, by contrast, establishes a much more important link between the investment and the country of nationality, but it is sometimes difficult to ascertain. A company may be owned by thousands of investors from many different countries, with the nationality of the dominant investors changing from time to time as shares in the company are traded. The inclusion of “ownership and control” as one of the criteria for attributing corporate nationality for the purpose of BIT protection represents a significant departure from traditional customary international law.

Basing the nationality on the location of a company’s seat may represent something of a middle ground. It establishes a more genuine link than mere incorporation and is often easier to ascertain and more stable than the country of ownership or control.

<sup>15</sup> *Ibid.*

<sup>16</sup> *Barcelona Traction, Light and Power Co., Ltd. (Belgium v. Spain) (1962–1970)*, preliminary objections — judgment of 24 July 1964; and second phase — judgment of 5 February 1970 (<http://www.icj-cij.org/icjwww/idecisions.htm>).

<sup>17</sup> In other words, the rationale of the Court was that, under customary international law, a company may be protected only by its country of incorporation, not the country of ownership. See Vandeveld (1992, pp. 45–46).

<sup>18</sup> The separate judgment of Judge Oda in the ELSI case in 1989 contains an affirmation of this rule. See also *AAPL vs. Sri Lanka* (1992), where it was held that the physical assets of a company incorporated in a host country are not protected by a BIT if they belong to a national of the host country. In such circumstances, the foreign investor can rely only on shareholder protection (Sornarajah, 2004).

<sup>19</sup> The GATS differentiates between the term “*own*” and the term “*control*”: a juridical person is “*owned*” by persons of a Member if more than 50 per cent of the equity interest in it is beneficially owned by persons of that Member, and it is “*controlled*” by persons of a Member if such persons have the power to name a majority of its directors or otherwise to legally direct its actions (Article XXVIII (n) of the GATS).

<sup>20</sup> See the example of the GATS cited above.

<sup>21</sup> Concerning the treatment of corporate nationality in dispute settlement procedures, see chapter K.1.a (ii) below.

<sup>22</sup> See *Aguas del Tunari v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Jurisdiction of 21 October 2005.

<sup>23</sup> See, for instance, the BIT between Australia and India (1999).

<sup>24</sup> Article 28 of the Vienna Convention reads as follows:

*“Non-Retroactivity of Treaties*

*Unless a different intention appears from the treaty or is otherwise established, its provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party.”*

<sup>25</sup> Protecting both existing and new investments could be justified on various grounds. The rationale for countries to provide protection to new investment is that such protection serves to prevent the undermining of investors’ confidence as regards reinvesting profits in the host country. Furthermore, by protecting investments already established countries refrain from altering the conditions of competition in favour of new investors to the detriment of those already located in the host country. Altering those conditions would not only distort the operation of the market, but also generate a negative reaction by existing investors against the conclusion of the new BIT (UNCTAD, 1998).

<sup>26</sup> “Countries not only may consider the provision of protection as a windfall to the investor, who decided to make the investment anyway, regardless of the existence of the agreement. Also, the prior investment may have not been admitted by the host country if the latter had realized that later such an investment would benefit from treaty protection.” *Ibid.*

<sup>27</sup> See footnote 25 above.

<sup>28</sup> It should be noted that, as far as the services sector is concerned, the GATS has adopted an intermediate approach between the two basic legal methods used in BITs. It provides for an establishment right concerning the setting up of a “commercial presence” on the condition that the relevant host country has undertaken a specific commitment in this respect (positive list approach). The GATS therefore does not go so far as to deny an establishment right altogether, nor does it make the granting of such a right a common obligation of all contracting parties.

<sup>29</sup> *Aguas del Tunari v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Jurisdiction of 21 October 2005.

<sup>30</sup> In the last decade (since 1995), the United States concluded 21 BITs and Canada 18.

<sup>31</sup> Recent research appears to indicate that this rationale for BITs does indeed work. See, for example, Neumeyer and Spess (2005).

<sup>32</sup> According to Walker, “*fair and equitable treatment denotes a non-contingent or absolute standard. This means that it applies to investments in a given situation without reference to standards that are applicable to other investment or entities; it may apply to other investments or entities, but its content does not vary according to how other investments or entities are treated.*” (Walker, 1957–1958, p. 811).

<sup>33</sup> Many BITs, after providing for fair and equitable treatment, add explicitly that investments by investors of the other contracting party should be provided with “full protection and security” or “most constant protection and security”. Unlike the fair and equitable treatment standard, the content of the principle of full protection and security has traditionally been defined with more precision. As pointed out by UNCTAD (1998), not only is this an “old” standard which was commonly used in Friendship, Commerce and Navigation (FCN) treaties, but it was also included separately in the earliest BITs signed before the OECD Draft Convention on the Protection of Foreign Property — before the concept of fair and equitable treatment had been introduced. In this regard, it has been pointed out that this “*provision does not impose strict liability on the host country to protect foreign investment. In effect, the standard does not represent a deviation from the due diligence rule. Thus, the term “full protection and security” connotes the assurance of full protection and security for foreign investors as contemplated or required by customary international law. At the same time, the clause on full protection and security is unusual in that it contemplates protecting investment against private as well as public action, that is, the clause requires that the host country should exercise reasonable care to protect investment against injury by private parties*” (UNCTAD, 1998, p. 55). “*Non-discrimination, in its general sense, means that the host country must abstain from discriminatory action towards foreign investors in general or towards specific groups of foreign investors. [...] Although arguably, the standard of fair and equitable treatment implicitly excludes arbitrary or discriminatory treatment, some BITs explicitly prohibit such treatment*” (ibid.). Recent arbitral awards came to different conclusions about whether the “fair and equitable treatment” standard includes a prohibition on discrimination (see *Methanex v. United States*, Decision on Amici Curiae of 15 January 2001, and Final Award of 3 August 2005; *Eureko v. Poland*, Partial Award of 19 August 2005).

<sup>34</sup> For an overview of the current discussion and the different interpretations of the clause by arbitration tribunals, see Dolzer (2005a), Juillard (1994) and Schreuer (2005).

<sup>35</sup> For a detailed explanation of this position, see UNCTAD (1999f).

<sup>36</sup> As has been clearly explained, according to this view: “*the strength and usefulness of the fair and equitable treatment standard lie in its relative lack of abstract content which appears to be aimed at ensuring the prudent and just application of legal rules...According to this view, the inclusion of this standard in BITs serves several purposes; not only does it provide a basic standard, it also provides a basic auxiliary element for interpretation of the other provisions in the agreement and for filling gaps in the treaty.*” Ibid., p. 54.

<sup>37</sup> For a detailed explanation of this subject, see UNCTAD (1999f).

<sup>38</sup> These standards have been developed in the “Neer” case (*Neer v. Mexico*, Opinion, United States – Mexico General Claims Commission, 15 October 1926, 21 A.J.I.L. 555, 1927). See also Brownlie (2003).

<sup>39</sup> See the previous footnote.

<sup>40</sup> In fact, this was one of the conclusions of the arbitral panel in the *Metalclad* dispute brought against Mexico in the context of the application of NAFTA’s Article 1105. That article explicitly links fair and equitable treatment to international law in a way that makes it relatively easy to find that a violation of another obligation also violates the principle of fair and equitable treatment.

<sup>41</sup> For a detailed discussion of NAFTA’s jurisprudence on Chapter 11 cases, see Dawson (2002), VanDuzer (2002), and Mann and von Moltke (1999).

<sup>42</sup> The relevant part of the Note of Interpretation issued by the Free Trade Commission states as follows:

“Having reviewed the operation of proceedings conducted under Chapter Eleven of the North American Free Trade Agreement, the Free Trade Commission hereby adopts the following interpretations of Chapter Eleven in order to clarify and reaffirm the meaning of certain of its provisions: [...]”

*B. Minimum Standard of Treatment in Accordance with International Law*

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.

2. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.

3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1)” (Note of Interpretation of the NAFTA Free Trade Commission, 31 July 2001).

<sup>43</sup> At the beginning of the 1990s, a very limited number of BITs did not make any reference to the fair and equitable treatment standard at all — for example, the BIT between Albania and Bulgaria (1994). However, countries that originally did not include the fair and equitable standard in their BITs later opted to do so. It should be noted that if a country has already provided fair and equitable treatment in at least one BIT, this level of protection must be provided to investors or investments of all other countries with which the country has concluded investment agreements containing an MFN clause, unless a specific exception was included in the agreement concerned. Thus, in many cases, it may make no practical difference

whether the fair and equitable treatment standard explicitly appears in a BIT, because it may still be applicable through the MFN clause in another applicable BIT.

<sup>44</sup> This is the case for at least 52 BITs concluded during the last decade. Among these are BITs concluded by Australia, Bahrain, Brunei Darussalam, Cambodia, Indonesia, Malaysia and Singapore.

<sup>45</sup> The scope of the MFN clause is dealt with in more detail in subsection E.2.b.1 below.

<sup>46</sup> For a detailed discussion on the admission clause, see section C above.

<sup>47</sup> See, for instance, *S.D. Meyers v. Canada*, UNCITRAL, First Partial Award of 13 November 2000.

<sup>48</sup> One of the most commented on cases that followed this approach was the 1991 “Tuna Case”, *United States – Restrictions on Imports of Tuna*, DS21/R, (unadopted) dated 3 September 1991 (WTO 1995).

<sup>49</sup> See *Methanex v. United States*, UNCITRAL, Decision on Amici Curiae of 15 January 2001, and Final Award of 3 August 2005; *Occidental Exploration and Production Company v. Republic of Ecuador*, LCIA Case No. UN3467, Final Award of 1 July 2004. See also Dolzer (2005b).

<sup>50</sup> *S.D. Meyers v. Canada*, UNCITRAL, First Partial Award of 13 November 2000; *Pope & Talbot Inc. v. Canada*, UNCITRAL, Award on Merits of 10 April 2001. See also VanDuzer (2002) and Dawson (2002).

<sup>51</sup> *Ibid.*

<sup>52</sup> Among numerous other agreements, treaties following this trend are the BITs between Chile and South Africa (1998), Argentina and New Zealand (1999), France and India (1997) and Mongolia and Singapore (1995).

<sup>53</sup> Examples of BITs falling within this category are, among others, the agreements between Japan, on the one hand, and Viet Nam (2003) and the Republic of Korea (2002) on the other hand. Other Japanese BITs, although in principle only applying to established investment, do provide MFN treatment at the entry stage. That is the case of the BITs between Japan and Bangladesh (1998), Hong Kong (China) (1997) and the Russian Federation (1998), respectively. Furthermore, most of the BITs of the United States and Canada — after the mid-1990s — fall within this category.

<sup>54</sup> The BITs between Botswana and China and between Australia and Argentina are two examples among numerous other BITs falling within this category. The most common exceptions to the MFN principle in BITs are explained below.

<sup>55</sup> An explanation might be that MFN treatment raises fewer objections, as the reasons for a host country to prefer foreign investors of a particular nationality may be limited.

<sup>56</sup> However, in this particular case, it should be noted that paragraph 2 of the same Article 3 cited above grants MFN treatment to investors of the contracting parties which is not conditioned on the domestic laws and regulations of the host country.

<sup>57</sup> That is the case of the BIT between China and Netherlands (2001), and the BIT between Cuba and Mexico (2001).

<sup>58</sup> Numerous agreements follow this approach. Examples are the agreements between China on the one hand, and Djibouti, Cambodia, Qatar and Brunei Darussalam, respectively, on the other hand.

<sup>59</sup> The BITs between Mexico and Greece (2000) and Australia and Egypt (2001) are two examples of the numerous agreements following this approach.

<sup>60</sup> *Emilio Agustin Maffezini v. Kingdom of Spain* (ICSID No. Apr/97/7). Decision on Jurisdiction of 25 January 2000 and Award of the Tribunal of 13 November 2000.

<sup>61</sup> See, for example: *Asian Agricultural Products Limited v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3. 1990, ICSID Reports 246; *Anglo-Iranian Oil Company Case*, International Court of Justice, Reports, 1952, p. 93; *Case concerning the rights of nationals of the United States of America in Morocco*, International Court of Justice, Reports, 1952, p. 176; and *Ambatielos Case*, International Court of Justice, Reports, 1953, p. 10.

<sup>62</sup> The Arbitral Tribunal elaborated on this point in greater detail and stated:

“63. Here it is possible to envisage a number of situations not present in the instant case. First, if one contracting party has conditioned its consent to arbitration on the exhaustion of local remedies, which the ICSID Convention allows, this requirement could not be bypassed by invoking the most favored nation clause in relation to a third-party agreement that does not contain this element since the stipulated condition reflects a fundamental rule of international law. Second, if the parties have agreed to a dispute settlement arrangement which includes the so-called fork in the road, that is, a choice between submission to domestic courts or to international arbitration, and where the choice once made becomes final and irreversible, this stipulation cannot be bypassed by invoking the clause. This conclusion is compelled by the consideration that it would upset the finality of arrangements that many countries deem important as a matter of public policy. Third, if the agreement provides for a particular arbitration forum, such as ICSID, for example, this option cannot be changed by invoking the clause, in order to refer the dispute to a different system of arbitration. Finally, if the parties have agreed to a highly institutionalized system of arbitration that incorporates precise rules of procedure, which is the case, for example, with regard to the North America Free Trade Agreement and similar arrangements, it is clear that neither of these mechanisms could be altered by the operation of the clause because these very specific provisions reflect the precise will of the contracting parties. Other elements of public policy limiting the operation of the clause will no doubt be identified by the parties or tribunals. It is clear, in any event, that a distinction has to be made between the legitimate extension of rights and benefits by means of the operation of the clause, on the one hand, and disruptive treaty-shopping that would play havoc with the policy objectives of underlying specific treaty provisions, on the other hand.”

<sup>63</sup> *Salini Construtorri S.p.A. and Italstrade S.p.A. v. Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 23 July 2001; *Siemens v. Argentina*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, 3 August 2004; *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005.

<sup>64</sup> The treatment of general exceptions in the BITs concluded in the last decade is addressed in section K below.

<sup>65</sup> Departures from this trend include the exceptions to the MFN standard contained in some BITs of the United States and Canada, which explicitly provide that MFN treatment does not apply to government procurement or subsidies or grants provided by a party, including government-supported loans, guarantees and insurance.

<sup>66</sup> For a detailed explanation of the different kind of annexes see section C above.

<sup>67</sup> Given that a foreign investor operates within the territory of a host country, the investor and its property are subject to the latter's legislative and administrative control. The risk assessment that a foreign investor makes at the time of entry may not be accurate since the host country's political and economic situation, and consequently, its internal policies relating to foreign investment may change. This could be brought about by several factors, such as a new Government, shifts in ideology, economic nationalism or monetary crises. Where these changes adversely affect foreign investment or require, in the view of the host country, a rearrangement of its economic structure, they may lead to the taking of property of a foreign investor.

<sup>68</sup> Expropriation clauses have traditionally been at the heart of BITs. This was clearly understandable considering the period in which BITs began to be negotiated. The 1960s were the decade of decolonization and also a time when most Governments in developing countries promoted heavy State intervention to foster import-substitution policies. This was also a period during which numerous developing countries focused their economic policy on asserting their national sovereignty, in particular over their natural resources. The risk of a foreign investor being subject to expropriation or nationalization was relatively high. It was also the period when the competing standard of appropriate compensation emerged. Within this context, capital-exporting countries had a clear incentive to negotiate investment regimes that would set a minimum standard of protection for their investments abroad.

<sup>69</sup> The distinction between these two kinds of takings has been that while "nationalizations" are undertaken for political purposes and may often affect entire sectors of the economy, "expropriations" are takings that are often limited to one specific firm and do not have a political background.

<sup>70</sup> For more on these various means see UNCTAD (2000a).

<sup>71</sup> See, for example, *S.D. Meyers v. Canada*, UNCITRAL, First Partial Award of 13 November 2000; *Marvin Roy Feldman v. The United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award on Merits of 16 December 2002.

<sup>72</sup> In this connection, see, inter alia, Mann and von Moltke (1999).

<sup>73</sup> This is an issue that several arbitral tribunals have addressed in the context of the application of Chapter 11 of NAFTA. Because NAFTA Article 1110 specifically refers to measures tantamount to expropriation as well as indirect expropriation, questions have been raised as to whether this provision could be interpreted as extending beyond protection against indirect expropriation. So far, in cases addressing the issue on the merits, such as *Pope & Talbot* and *S.D. Myers*, it has been held that the reference to "tantamount to nationalization or expropriation" does not expand the expropriation standard beyond what is conventionally considered an indirect expropriation.

<sup>74</sup> The BIT between Lebanon and Malaysia (2003) is an example.

<sup>75</sup> The provision cited above could be interpreted as stating that the contracting parties shall abstain from taking "any measures" of expropriation, and that by using the plural form, the article envisages the possibility of its applying to more than one type of expropriation measure. Within this logic, measures having an effect equivalent to that of an expropriation would also be "measures of expropriation" for the purposes of the agreement. On the other hand, it could also be argued that the text of the provision refers only to measures of expropriation, and not to other kinds of measures, regardless of whether the latter have a effect equivalent to that of the former.

<sup>76</sup> Prompt, adequate and effective compensation was a standard advocated by former US Secretary of State Cordell Hull in his communication to the Mexican Government during the expropriation of American assets in 1939. This approach is thus known as the "Hull formula".

<sup>77</sup> In this regard, see article 4.2. of the BIT between the Russian Federation and Thailand (2002) cited above.

<sup>78</sup> While almost any national currency can be convertible, only a limited group of hard currencies are considered by the IMF to be *freely usable*. Among the latter are the United States dollar, the euro, the pound sterling, the Swiss franc and the Japanese yen.

<sup>79</sup> See also *Asian Agricultural Products Ltd. v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3, 27 June 1990.

<sup>80</sup> There is a reason for this distinction. While it could be argued that in situations of war or civil unrest the damage can be caused by actions or omissions of the country, in situations of natural disasters, which are usually fortuitous, the country does not play a role in generating the damage.

<sup>81</sup> This is the case of the BIT between Argentina and Mexico (1996), which does not have a compensation for losses clause.

<sup>82</sup> See above chapter D.1.

<sup>83</sup> The BIT between China and Djibouti (2003) is an example.

<sup>84</sup> A similar situation exists with regard to several other BITs of India, such as with Australia (1999), Austria (1999), Croatia (2001), Indonesia (1999) and Sweden (2000).

<sup>85</sup> During the last decade, BITs applying this approach include the treaties between France and Albania (1995), Azerbaijan (1998), Cambodia (2000), Cuba (1997), the Dominican Republic (1999), India (1997), Mexico (1998) and Uganda (2002), as well as those between Denmark and Algeria (1999), Cuba (2001), India (1995), Kuwait (2001), Kyrgyzstan (2001), the Lao People's Democratic Republic (1998), Mongolia (1995), Nicaragua (1995), Pakistan (1996) and the Philippines (1997).

<sup>86</sup> The BIT between Brunei Darussalam and the Republic of Korea (2000) is an illustration.

<sup>87</sup> The BIT between Hong Kong (China) and Japan (1997) is an example.

<sup>88</sup> The BIT between Ethiopia and the Russian Federation (2000) illustrates this approach.

<sup>89</sup> For example, the BIT between Austria and Saudi Arabia (2001) provides that the host country should normally process a transfer in no more than one month. By contrast, the BIT between Brunei Darussalam and China (2000) provides for a time frame of no more than four months in which to process the transfer.

<sup>90</sup> The applicable legislation no longer obliges the Chilean Government to apply the restriction previously mentioned. However, restricting capital outflows remains discretionary for the competent authorities in Chile, and thus Chilean BITs usually include this exception.

<sup>91</sup> This is the case because this sector has a double role: not only is it a significant sector in its own, but also the state of the financial services sector has a direct impact on the other sectors of the economy.

<sup>92</sup> As of 1 February 2007.

<sup>93</sup> Very similar provisions are also included in numerous other BITs under review. See, for instance, the BITs between Thailand and Argentina (2000), Bahrain (2002), Bulgaria (2003) and India (2001); between Belgium–Luxembourg and Costa Rica (2002), Pakistan (1998) and Philippines (1998); between Saudi Arabia and Austria (2001), and the Republic of Korea (2002); and between India and Austria (1999), Croatia (2001), Indonesia (1999), Ghana (2002) and Sweden (2002).

<sup>94</sup> This paragraph illustrates what is known as an “umbrella clause”, which incorporates into the BIT obligations that the host country may have assumed in a different context. This kind of clause is addressed in more detail in subsection I.4 below.

<sup>95</sup> Not all BITs negotiated by Finland during the last decade contain this provision. In this regard, see, inter alia, the BITs between Finland and Brazil (1995), China (2004), Lebanon (1997), Mexico (1999), Oman (1997), the Philippines (1998), Poland (1996), Slovenia (1998), South Africa (1998) and the United Arab Emirates (1996).

<sup>96</sup> BITs negotiated by Canada during the last decade using this approach include the agreements with Armenia (1997), Barbados (1996), Croatia (1997), Ecuador (1996), Egypt (1996), El Salvador (1999), Latvia (1995), Lebanon (1997), Panama (1996), Romania (1996), South Africa (1995), Trinidad and Tobago (1995), and Uruguay (1997). Concerning the US treaty practice, see, for example, the BITs with Albania (1995), Azerbaijan (1997), Bahrain (1999), Bolivia (1998), Croatia (1996), El Salvador (1999), Honduras (1995), Jordan (1997), Mozambique (1998) and Nicaragua (1995).

<sup>97</sup> See also UNCTAD (1998, pp. 83–84).

<sup>98</sup> However, numerous BITs contain provisions dealing with the entry and sojourn of foreign personnel *in general* (see above).

<sup>99</sup> This method is used in BITs that allow countries to make exceptions to some obligations on a negative-list basis. Thus, although non-conforming laws could be reserved, once the BIT enters into force, no new discriminatory restrictions are allowed that would affect the investors’ right to appoint top managerial personnel of their choice.

<sup>100</sup> Figure cited in Gill, Gearing and Birt (2004, footnote 31).

<sup>101</sup> See *SGS Société de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of 16 October 2002.

<sup>102</sup> See *SGS Société de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of 29 January 2004.

<sup>103</sup> See also OECD (2006).

<sup>104</sup> *Metalclad Corp. v. United Mexican States*, Award of 30 August 2000.

<sup>105</sup> This takes up an approach already incorporated into Article VI of the GATS.

<sup>106</sup> This approach is used in all other BITs negotiated by New Zealand over the last decade, such as in Article 8 of the BIT with Hong Kong (China) (1995) and Article 8 of the BIT with Chile (1999).

<sup>107</sup> In this BIT, Article 1 refers to definitions, Article 3 to access to tribunals, Article 7 to transparency, Article 9 to fair and equitable treatment and expropriation, Article 22 to local governments and denial of benefits, and Article 23 to final provisions (footnote added).

<sup>108</sup> In this BIT, Article 13 refers to State-State dispute settlement and Article 14 to investor-State dispute settlement (footnote added).

<sup>109</sup> In this BIT, Article 20 sets up a Joint Committee to oversee the implementation of the agreement (footnote added).

<sup>110</sup> Article 3 of the BIT between Germany and Mexico (1998) provides as follows:

*“Treatment of Investments*

1. Each Contracting State shall ensure to investments in its territory that are owned or controlled by nationals or companies of the other Contracting State, treatment no less favourable than that granted to investments of its own nationals and companies, or to investments of nationals and companies of any third State.

2. Each Contracting State in its territory shall accord to nationals or companies of the other Contracting State, with respect to the activities mentioned in Article 2, paragraph 3 and related to its investments, treatment not less favourable than that accorded to its own nationals and companies or nationals and companies of any third State.

3. The aforesaid treatment does not refer to special advantages that one of the Contracting States grants to nationals or companies of a third State by virtue of an agreement establishing a free trade area, customs unions, a common market or by virtue of its associations with such organizations.

4. The treatment agreed by the present Article does not refer to the advantages that one of the Contracting States grants to the nationals or companies of a third State by virtue of an agreement on the avoidance of double taxation or any other agreement in tax matters.” (footnote added)

<sup>111</sup> Article 10 of the BIT between Japan and Viet Nam (2003) refers to compensation for losses in cases of civil strife (footnote added).

<sup>112</sup> Article 11 stipulates the following:

*“An investor of a Contracting Party, which has suffered loss or damage relating to its investment and business activities in the territory of the other Contracting Party due to hostilities or a state of emergency such as revolution, insurrection, civil disturbance or any other similar event in the territory of that other Contracting Party, shall be accorded by that other Contracting Party, as regards restitution, indemnification, compensation or any other settlement, treatment no less favourable than that which it accords to its own investors or to investors of any third country, whichever is more favourable to the investor.”* (footnote added).

<sup>112</sup> The provision reads as follows:

*“Article 16*

*[...]*

*2. In cases where a Contracting Party takes any measure, pursuant to paragraph 1 above, that does not conform with the obligations of the provisions of this Agreement other than the provisions of Article 11, that Contracting Party shall not use such measure as a means of avoiding its obligations.*

*3. In cases where a Contracting Party takes any measure, pursuant to paragraph 1 above, that does not conform with the obligations of the provisions of this Agreement other than the provisions of Article 11, that Contracting Party shall, prior to the entry into force of the measure or as soon thereafter as possible, notify the other Contracting Party of the following elements of the measure: (a) sector and sub-sector or matter; (b) obligation or article in respect of which the measure is taken; (c) legal source or authority of the measure; (d) succinct description of the measure; and (e) motivation or purpose of the measure. [...]*”

<sup>113</sup> It could be argued that protection of the environment comprises in broad terms not only the protection of natural resources but also the protection of human, animal and plant life or health.

<sup>114</sup> See section F.1 above.

<sup>115</sup> Only a minority of the agreements signed by France during the last decade include a cultural exception. For instance, the exception is not included in the BITs with Albania (1995), Armenia (1995), Azerbaijan (1998), Cambodia (2000), Cuba (1997), the Dominican Republic (1999), Ghana (1999), Guatemala (1998), Honduras (1998), Hong Kong (China) (1995), India (1997), Kazakhstan (1998), Lebanon (1996), Namibia (1998), Nicaragua (1998), Romania (1995), Slovenia (1998) and South Africa (1995).

<sup>116</sup> This exception is identical to the one included in Article 2.3 of the BIT between France and Mexico (1998).

<sup>117</sup> This exception has been included in all BITs negotiated by Canada during the last decade, such as the BITs with Armenia (1997), Barbados (1996), Costa Rica (1998), Croatia (1997), Ecuador (1996), Egypt (1996), El Salvador (1999), Latvia (1995), Lebanon (1997), Panama (1996), the Philippines (1995), Romania (1996), Slovakia (2001), South Africa (1995), Thailand (1997), Trinidad and Tobago (1995), Uruguay (1997) and Venezuela (1996). The same exception was also incorporated into Article 10.6 of the 2004 Canadian Model BIT.

<sup>118</sup> Article 8 of the BIT between Chile and New Zealand (1999) is an example of this trend. This provision stipulates that the BIT *“[...] shall not apply to Tokelau unless the Contracting Parties have exchanged notes agreeing to the terms on which this Agreement shall so apply”*. Tokelau is a group of three atolls in the South Pacific Ocean. Originally settled by Polynesian emigrants from surrounding island groups, the Tokelau Islands were made a British protectorate in 1889. They were transferred to New Zealand administration in 1925.

<sup>119</sup> An example of a general exception for this purpose is the BIT between Japan and Viet Nam (2003):

*“Article 18*

*1. Nothing in this Agreement shall be construed so as to derogate from the rights and obligations under multilateral agreements in respect of protection of intellectual property rights to which the Contracting Parties are parties.*

*2. Nothing in this Agreement shall be construed so as to oblige either Contracting Party to extend to investors of the other Contracting Party and their investments treatment accorded to investors of any third country and their investments by virtue of multilateral agreements in respect of protection of intellectual property rights, to which the former Contracting Party is a party. [...]*”

<sup>120</sup> For more detail on the evolution of preambles in BITs see section A above.

<sup>121</sup> The same trend can be observed in the preambles of the BITs between Mozambique and the Netherlands (2001), Japan and Viet Nam (2003), and Japan and the Republic of Korea (2002), among others.

<sup>122</sup> Article 11 of the 2004 Canadian Model BIT includes very similar language. This provision is cited below when the subject of environmental protection is addressed.

<sup>123</sup> An exception to this trend is the BIT between the United States and Uruguay (2005), which in its preamble makes reference to the intention of the contracting parties to achieve the objectives of the BIT in a manner consistent with the protection of the environment, and also contains specific provisions on this particular subject in the body of the agreement.

<sup>124</sup> This group of BITs includes the agreements between Belgium–Luxembourg and Botswana (2003), Ethiopia (2003) and Mauritius (2003), among others.

<sup>125</sup> Articles 24.1(a)(i)(A) and 24.1(b)(i)(A) provide that, for the purposes of the investor–State dispute settlement procedures, investors can only submit claims arguing that the host country has violated Articles 3 to 10 of the BIT. The commitment on environment is in Article 12.

<sup>126</sup> Article 37.5 of the BIT explicitly provides that State–State dispute settlement procedures “...shall not apply to a matter arising under Article 12 or Article 13”.

<sup>127</sup> Article 12.1 is complemented by a second paragraph, which provides as follows:

[...]

“2. Nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.”

This provision is commented on in subsection 1.c above, where the exceptions on the protection of natural resources are explained.

<sup>128</sup> This is the case of the BITs negotiated between Belgium–Luxembourg and countries such as Botswana (2003), Ethiopia (2003), Mauritius (2005) and Zimbabwe (2003).

<sup>129</sup> Footnote 14 to Article 13.2 states as follows: “For the United States, “statutes or regulations” for purposes of this Article means an act of the United States Congress or regulations promulgated pursuant to an act of the United States Congress that is enforceable by action of the central level of government.”

<sup>130</sup> Articles 24.1(a)(i)(A) and 24.1(b)(i)(A) provide that, for the purposes of the investor–State dispute settlement procedures, investors can only submit claims arguing that the host country has violated Articles 3 to 10 of the BIT. The commitment on labour standards is in Article 13. Article 37.5 of the BIT explicitly provides that State–State dispute settlement procedures “[...] shall not apply to a matter arising under Article 12 or Article 13”.

<sup>131</sup> The concept of “rule-oriented” adjudication mechanisms contrasts with “power-oriented” means of peaceful dispute resolution. “In broad perspective one can roughly divide the various techniques for peaceful settlement of international disputes in two types: settlement by negotiation and agreement with reference (explicitly or implicitly) to relative power status of the parties; or settlement by negotiation or decision with reference to norms or rules to which both parties have previously agreed [...] To a large degree, the history of civilization may be described as a gradual evolution from a power-oriented approach, in the state of nature, towards a rule-oriented approach. [...] [There are] advantages which accrue generally to international affairs through a rule-oriented approach –less reliance on raw power, and the temptation to exercise it or flex one’s muscles, which can get out of hand; a fairer break for the smaller countries, or at least a perception of greater fairness [...]” (Jackson, 1997).

<sup>132</sup> This approach has also been used in other BITs of Australia over the last decade, such as those negotiated with Argentina (1995), Lithuania (1998), Pakistan (1998), Peru (1995), the Philippines (1995), Sri Lanka (2002) and Uruguay (2001).

<sup>133</sup> An example of this approach is illustrated by the BIT between Chile and Egypt (1999), which in its Article 8.6 states that “[...] Once a dispute has been submitted to the competent tribunal or international arbitration in accordance with this Article, neither Contracting Party shall pursue the dispute through diplomatic channels unless the other Contracting Party has failed to abide or comply with any judgment, award, order or other determination made by the competent international or local tribunal in question”.

<sup>134</sup> Article 27.1 of the ICSID Convention states that “No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.”

<sup>135</sup> Among the BITs following this approach are the agreements between Australia and Chile (1996), Cambodia and the Republic of Korea (1997), and Eritrea and Uganda (2001).

<sup>136</sup> BITs following this approach are, among others, those between Cambodia and China (1996) and Bahrain and China (1999).

<sup>137</sup> Other BITs, such as the agreements between Chile and Indonesia (1999) and Bahrain and China (1999), provide for a consultation period of four and five months respectively.

<sup>138</sup> Under customary international law, a home country may generally not espouse a private investor’s claim against a host country unless the investor has first exhausted local remedies (UNCTAD, 1998).

<sup>139</sup> Among the BITs using this approach are the agreements between China and Bahrain (1999), Bosnia and Herzegovina (2000), Botswana (2000), Guyana (2003), Jordan (2001), Qatar (1999), Trinidad and Tobago (2002) and Djibouti (2003).

<sup>140</sup> Paragraph (6) of Article 8 cited above provides that “A disputing investor may submit a claim to arbitration only if he consents to arbitration in accordance with the procedures set out in this Agreement and waives his right to initiate before any administrative tribunal or court under the law of a Contracting Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Contracting Party that is alleged to be a breach of this Agreement.” The importance of this waiver lies in preventing the dispute from being submitted to more than one forum, as explained in subsection L.b below.

<sup>141</sup> Among others, this approach is used in BITs between Austria and Armenia (2001), Bosnia and Herzegovina (2000), Jordan (2001), the Libyan Arab Jamahiriya (2002), Lebanon (2001), the Former Yugoslav Republic of Macedonia (2001), Mexico (1998), the United Arab Emirates (2001) and Uzbekistan (2000).

<sup>142</sup> Some BITs refer to regional arbitration forums such as the Cairo Regional Centre for International Commercial Arbitration (see, for example, the BIT between Egypt and Nigeria (2000) and the BIT between Egypt and Pakistan (2000)) or

the Arab Investment Court (see, for example, the BIT between Egypt and the Syrian Arab Republic (1997) and the BIT between Jordan and the Syrian Arab Republic (2001)).

<sup>143</sup> The promotion of judicial economy is one of the policies behind a series of innovations in investor—State dispute settlement provisions in BITs. This point is developed in subsection L.b below.

<sup>144</sup> As subsection L.1.a.(i) above also explains, some BITs require that for an investor to have standing, it is necessary that the claim consists in an alleged violation of the agreement and that such breach has generated a loss to the detriment of the investor. However, most of the BITs requiring this standing also tend to explicitly recognize the possibility for the investor to invoke arbitration procedures, even if compensation under an insurance contract has previously been granted. For instance, see Article 10 of the Annex of the BIT between Cuba and Mexico (2001), Article IX of the BIT between Jordan and the United States (1997), and Article 15 of the BIT between Austria and Bosnia Herzegovina (2000), among others.

<sup>145</sup> Article V of the New York Convention provides the following:

*“Article V*

1. *Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:*
  - (a) *The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or*
  - (b) *The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or*
  - (c) *The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decision on matters submitted to arbitration can be separated from those not submitted, the part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or*
  - (d) *The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or failing such agreement, was not in accordance with the law of the country where the arbitration took place; or*
  - (e) *The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.*
2. *Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:*
  - (a) *The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or*
  - (b) *The recognition or enforcement of the award would be contrary to the public policy of that country.”*

<sup>146</sup> For instance, Article 27.1 of the ICSID Convention explicitly provides that “no Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.”

<sup>147</sup> However, some BITs do not address this matter.

<sup>148</sup> For instance, the BIT between Armenia and Austria (2001) has a chapter on dispute settlement, one part of which, containing six articles, regulates investor—State arbitration. Other BITs that include detailed investor—State dispute settlement provisions are the agreements of Austria with Bosnia and Herzegovina (2000), Jordan (2001), Lebanon (2001), the Libyan Arab Jamahiriya (2002), the Former Yugoslav Republic of Macedonia (2001), the United Arab Emirates (2001) and Uzbekistan (2000), among others. The 2004 Canadian Model BIT has a whole section, comprising 27 provisions and two annexes, on investor—State dispute settlement. Furthermore, the BIT between Finland and Mexico (1999) has a section with 10 provisions on investor—State dispute settlement. The same approach applies to the BITs that Mexico has concluded with Belgium—Luxembourg (1998), Cuba (2001), Germany (1998), Greece (2000), the Netherlands (1998), Portugal (1999), the Republic of Korea (2000) and Sweden (2000), among others.

<sup>149</sup> See UNCTAD (2005b).

<sup>150</sup> DR-CAFTA even goes further, and provides for the establishment of a negotiating group to draft an amendment to the agreement authorizing the establishment of an appellate body within one year after the entry into force of the treaty.

<sup>151</sup> For example, the BIT between China and Guyana (2003) provides for a period of six months from the date on which either contracting party raised the matter. Examples of shorter periods include the BIT between Austria and Bosnia and Herzegovina (2000), which allows a contracting party to initiate the proceedings 60 days after notification of the intention to do so.

<sup>152</sup> This is the case of United States' BITs, for instance the BIT with Uruguay (2005). This approach has already been used in BITs negotiated earlier in this period, such as in the BITs between the United States and Azerbaijan (1997), Bahrain (1999), Jordan (1997) and Mozambique (1998).

<sup>153</sup> This is the case of most BITs of the United States.

<sup>154</sup> For instance, the BIT between Mexico and the Netherlands (1998) provides that:



*“Article 11**Settlement of Disputes between the Contracting Parties*

[...]

*(5) The tribunal shall decide on the basis of respect for the law. Before the tribunal decides, it may at any stage of the proceedings propose to the Contracting Parties that the dispute be settled amicably. The foregoing provisions shall not prejudice settlement of the dispute ex aequo et bono if the Contracting Parties so agree. [...]*

<sup>155</sup>

*“Article 37: State-State Dispute Settlement*

[...]

*4. Articles 28(3)[amicus curiae], 29,[Transparency of Arbitral Proceedings] 30(1) [Governing Law]and 31[Interpretation of Annexes] shall apply mutatis mutandis to arbitrations under this Article.”*



## **CONCLUSIONS: EVOLUTION IN INVESTMENT RULEMAKING — NEW CHALLENGES FOR DEVELOPING COUNTRIES**

This study has shown that BITs concluded since the late 1990s continue to have a structure and a content similar to those of earlier BITs. However, the fact that most BITs address basically the same issues does not mean that they have the same underlying rationale, nor does it mean that all agreements provide the same degree of investment protection or have evolved homogeneously over the last decade. Rather, the enormous increase in BITs during the review period has resulted in a greater variety of approaches with regard to individual aspects of their content. A small number of BITs has introduced some significant innovations. These BIT developments have also been reflected in the investment chapters of free trade agreements and other recent economic integration agreements concluded by countries (UNCTAD, 2006c).

### **A. Similarities and dissimilarities between BITs**

Core elements found in most BITs include provisions on the scope of application, entry and establishment of investment, fair and equitable treatment, national treatment and MFN treatment, expropriation and compensation, transfer of funds and dispute settlement, both between contracting parties and between a contracting party and an investor.<sup>1</sup> However, despite including provisions addressing basically the same issues, BITs negotiated over the last decade have adopted a variety of approaches concerning specific aspects of investment promotion and protection. Two main models can be distinguished.

Continuing with a trend that already existed in the mid-1990s, the overwhelming majority of BITs negotiated during the last decade follow the traditional “admission” model. These agreements apply to investment only once it has been admitted into the host country in accordance with the latter’s domestic laws and regulations. Within this group of BITs, important differences exist regarding the degree of precision of several key obligations applying to established investments (see below). A minority of BITs provide relatively little protection to foreign investment. For instance, these BITs do not provide national treatment even after the investment has been admitted in accordance with the laws and regulations of the host country.<sup>2</sup> In other BITs falling into this category, standards such as the freedom of transfers, or even fair and equitable treatment, have been subject to domestic legislation. This weakens the degree of protection afforded to the investor.

Another — relatively small — category of BITs imposes a higher degree of discipline on the contracting parties compared with the previous categories. These agreements are geared to both investment liberalization and protection. In addition to applying to investments both in the pre- and post-establishment phases, these BITs include commitments on certain issues often not covered by treaties based on the “admission” model, such as performance requirements, top managerial personnel, and, more recently, transparency. These are the BITs negotiated by the United States since the 1980s, by Canada after the mid-1990s and by Japan at the beginning of this century. Over the last 10 years, these countries have concluded more than 40 new BITs providing national treatment and MFN treatment in the pre-establishment phase. However, considering that during this period more than a thousand agreements were negotiated, these BITs are still a small minority.

### **B. Assessment in terms of innovations in investment rulemaking**

The vast majority of BITs concluded during the review period follows drafting and regulatory approaches typical of treaties negotiated before the mid-1990s. These treaties therefore demonstrate the considerable degree of common ground that has been achieved over the last few decades concerning the main content of BITs. On the other hand, a relatively small, but increasing, group of BITs have started to introduce some innovations in investment rulemaking.

An important distinction to be made is that — with the exception of the first subsequent category (“protection of public policy concerns”) — all other types of innovations are mainly limited to BITs

concluded by a few countries, including Canada, Colombia, Japan, the Republic of Korea and the United States.

### 1. Protection of public policy concerns

Against the background of the ongoing debate about possible negative effects of FDI, a growing number of countries emphasize in their BITs that *investment protection made must not be pursued at the expense of other legitimate public concerns*. To that end, more recourse is made to treaty exceptions, thereby safeguarding the right of the host country to enact regulations — even inconsistent with the obligations in the BIT. In addition to the "traditional" areas where such exceptions have been a common feature of BITs for many years, namely taxation and regional economic integration, more agreements now also exempt from the scope of the BIT — fully or partially — host country measures related to such diverse fields as essential security and public order, protection of health, safety and natural resources, cultural diversity, and prudential measures for financial services. These exceptions show the scale of values in the policymaking of contracting parties, and subordinate investment protection to those other key policy objectives.

The proliferation of general exceptions does not respond to a particular regional pattern. Rather, the increase in general treaty exceptions in BITs is a *worldwide trend*.<sup>3</sup> However, some countries emphasize the protection of certain policy objectives more than others.<sup>4</sup>

Instead of using general exceptions, other BITs have included positive language — either in their preambles or in specific provisions in the body of the text — to reinforce the commitments of the contracting parties to safeguard certain values, basically the protection of health, safety, the environment, and the promotion of internationally recognized labour rights. Although this approach has legal effects that are different from those of a general exception, it gives the same political signal that contracting parties do not place investment protection above other important public policy objectives. Once again, this approach is *not limited to specific countries or regions*.<sup>5</sup>

### 2. Other innovations

A small group of BITs concluded over the last decade include further innovations in investment rulemaking. As previously stated, the new model BITs of Canada and the United States exemplify this approach. The normative evolution has focused on a number of areas: to clarify individual BIT provisions; to provide greater transparency; and to improve the transparency and predictability of dispute settlement.

#### *Clarification of individual BIT provisions*

Most BITs continue to use very general language, such as the provisions on fair and equitable treatment, MFN treatment and expropriation. In view of Canada's and the United States' past involvement in numerous investor-State disputes, recent BITs of those countries have departed from this approach and spell out in more detail the content of some core provisions.

One example is the definition of "*investment*". The new Canadian model BIT has replaced the open-ended, asset-based definition with a comprehensive and finite definition. The recent BIT between the United States and Uruguay (2005), on the other hand, has opted to define the term "*investment*" in economic terms; in principle, it covers every asset that an investor owns and controls, but adds that such assets must have the "*characteristics of an investment*", such as "*the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk*". Also, several kinds of assets not considered to be covered investments under the agreement are excluded. Both approaches attempt to strike a balance between maintaining a comprehensive investment definition and excluding assets that are not intended by the parties to be covered.

Another trend is the revision of the wording of various substantive treaty obligations. The new Canadian and United States model BITs, learning from the technical intricacies faced in the implementation of the investment chapter of NAFTA, use more detailed language and elaborate on the meaning of absolute standards of protection, in particular the minimum standard of treatment in accordance with international law

and indirect expropriation. The new language is geared to indicating that both sets of obligations are intended to reflect the level of protection granted by customary international law. In addition, both BIT models include annexes specifying guidelines and criteria in order to determine on a case-by-case basis whether an indirect expropriation has in fact taken place.

### *Transparency*

Recent BITs of Canada and the United States explicitly deal with the issue of transparency. There has been a gradual evolution in the rationale and content of the obligations on this subject. Where once transparency was regarded as an obligation imposed on contracting parties to exchange information, this kind of BIT also considers transparency to be a reciprocal commitment between the host country and the investor. Furthermore, transparency is extended to the process of domestic rulemaking, aimed at allowing investors and other interested persons to participate in it. These transparency obligations are not subject to the ISDS provisions — that is, they are not enforceable by investors.

### *Investor–State dispute settlement*

Another feature of recent Canadian and United States BITs is their significant innovation regarding investor–State dispute settlement. This includes greater and substantial transparency in arbitral proceedings, open hearings, publication of related legal documents and the possibility for representatives of civil society to submit *amicus curiae* briefs to arbitral tribunals. Other new detailed clauses provide for more law-oriented, predictable and orderly conduct at the different stages of the investor–State dispute settlement process. The Canadian model BIT, for example, even includes specific standard waiver forms to facilitate waivers as required by the agreement for the purposes of filing a claim. The BIT between the United States and Uruguay (2005) not only provides for a special procedure at the early stages of the investor–State dispute settlement process aimed at eliminating frivolous claims, but also envisages the possibility of setting up an appellate mechanism to foster a more consistent and rigorous application of international law in arbitral awards.

Mexico is another country that has introduced innovations on investor–State dispute settlement in its BITs. After negotiating Chapter 11 of NAFTA, Mexico started to negotiate BITs with several countries, mostly in Europe and Asia, incorporating some of the specific clauses included in Chapter 11. After the negotiation of the BIT with Austria in 1998, it seems that the latter country followed suit and included more detailed investor–State dispute settlement provisions in some — though not all — of its subsequent agreements.

## **C. Implications**

BIT negotiations during the last decade have two main characteristics. First, the enormous increase in BITs has resulted in a remarkable degree of similarity as far as their *basic structure and content* are concerned. Apart from the traditional divide between BITs with and without liberalization commitments, there is no major disagreement about what should be the core elements of a BIT and what basic content its key provisions should have. Second, despite this broad general consensus, it is clear that the picture becomes much more diverse when one looks into the details of individual BIT provisions. In this respect, it is fair to say that the level of variation between BITs has increased during the review period. While some differences relate to the substance of the provisions, others concern only minor linguistic variations, although sometimes with major implications. A few issues stand out as the most important new developments. They include the introduction of additional elements of investment protection, a greater emphasis on key public policy concerns as a counterweight to investment protection, the clarification of individual treaty provisions, more transparency and more detailed rules on investor–State dispute settlement.

The consolidation of core BIT provisions should contribute to facilitating future negotiations on international investment rulemaking and gives foreign investors more assurance about what they can reasonably expect from host countries as investment protection. The greater diversity of BITs when it comes to the details of the agreement reflects the flexibility that countries would like to have in choosing the

partners to enter into an agreement, and to tailor individual agreements to their specific situations, development objectives and public concerns. Furthermore, more elaborate rules may enhance legal clarity on rights and obligations, and may fill existing gaps in the overall treatment of foreign investment.

On the other hand, the developments in BIT negotiations also mean that the last decade has witnessed the emergence of a new pattern in international investment rulemaking. In addition to the different approaches to investment liberalization in BITs, one can now also distinguish agreements according to their degree of complexity. However, it needs to be underlined that BITs with more elaborate structures are still a relatively small minority. Furthermore, to some extent these BITs might *look* more different on paper than they really are, since they are not intended to substantially deviate from or even contradict “traditional” BITs. Rather, to some degree these more complex BITs “only” spell out explicitly what contracting parties to conventional agreements implicitly have in mind when concluding the treaty. All this suggests that these differences are less significant than the divide between BITs that include liberalization commitments and those that do not.

Nevertheless, the growing diversity of the BIT universe poses new challenges for keeping it coherent. The risk of incoherence is particularly great for developing countries that lack expertise and bargaining power in investment rulemaking, and that may have to conduct negotiations on the basis of divergent model agreements of their negotiating partners (UNCTAD 2006b). Already in the past, developing countries concluded different kinds of BITs, depending on whether their developed market economy treaty partner followed the approach of excluding or including pre-establishment obligations in the agreement. With the recent emergence of more complex BITs, an additional layer of potential incoherence has been introduced.

One example is the more frequent recourse to exception clauses in recent BITs. It could mean that a developing country's measures to protect certain public values (e.g. national security or the environment) are not subject to the disciplines of some BITs while others cover them. Another illustration is the interpretation of the international minimum standard in accordance with the principles of customary international law in recent Canadian and United States BITs. Although these interpretative clauses are intended only to clarify the content of the provision and do not therefore set out to introduce substantive amendments, they may have a decisive impact on arbitration proceedings. As a result, tribunals might arrive at different conclusions with regard to the legality of basically the same host country measure, depending on whether the BIT contains an interpretative statement.

It remains to be seen whether the future development of BIT negotiations will result in a gradual convergence of the different models. To a considerable extent this will depend on the further evolution of investment disputes. Many of the recent changes that Canada and the United States have made in their BITs reflect their arbitration experience. If ever more countries become defendants in investment disputes and if they consider that arbitration tribunals have too much discretion in interpreting BIT provisions, they might wish to follow the Canadian and United States approach. However, it is also possible that the substantial increase in investment disputes (and awards) results in a consolidation of case law that makes the outcome of future arbitration both more predictable and acceptable and thereby reduces the need for interpretative statements in the BITs.

For the time being, the MFN principle included in most BITs could contribute to furthering coherence between different agreements. It might ensure, at least in principle, that an investment from a country with a “lower” protection standard BIT will receive treatment no less favourable than the treatment granted to an investment from a country with a “higher” protection standard BIT. The MFN standard could therefore have the effect of “levelling the playing field” for the protection that is provided to investors of different nationalities.

Applying the MFN principle to BITs with different degrees of complexity might be a challenging task. On the one hand, it might mean that the BIT provision with the higher level of sophistication becomes applicable. This could be the case, for instance, if one BIT grants the foreign investor additional rights with regard to transparency or in dispute settlement proceedings. On the other hand, the greater complexity of one BIT might also imply a reduction in the level of investment protection as compared with other BITs with the

result that this BIT provision could become inapplicable. For example, if BIT A includes an unqualified obligation to grant fair and equitable treatment, and BIT B states that such treatment refers only to the international minimum standard, the MFN clause in BIT B might override this statement. The result might be similar if one BIT includes a specific exception and the other does not. Such policy coherence through the MFN clause could render useless the efforts of contracting parties to distinguish their BIT from other agreements. It also needs to be underlined that the scope and effect of the MFN clause has become uncertain in the light of some recent contradictory awards.<sup>6</sup>

Another challenge for developing countries in future BIT negotiations has to do with the fact that a growing number of them are becoming capital exporters. As a result, they are not only concerned about ensuring sufficient flexibility for themselves in regulating inward FDI, but also seek to provide their investors with ample protection abroad. Reconciling these two potentially conflicting interests may not be easy.

#### **D. The development dimension**

Beyond the inherent objective of investment protection that BITs pursue, the vast majority does not directly address specific development-related issues. As in the past, most recent BITs include language stressing the importance of encouraging foreign investment, creating favourable conditions for it, and the like. However, they rarely contain an obligation to promote investments — that is, whereas there is a duty on the part of the host countries to protect investment, there is no *quid pro quo* in treaties that would oblige home countries to promote flows of investment.

Some BITs concluded in the review period have explicitly adopted development-oriented provisions that refer to the notions of investment promotion and facilitation, including home country measures. A number of BITs contain provisions for the exchange of information with regard to investment opportunities, and some go so far as to call for the offering of incentives and the establishment of investment promotion offices. Few BITs also contain provisions concerning the establishment of institutional mechanisms to follow up on the application and interpretation of the treaty — a matter that has been identified as development-friendly, as it allows the contracting parties to review their obligations and to adapt them to changing circumstances.<sup>7</sup> A few BITs also contain specific exceptions and safeguards that are intended to cater for the different objectives and needs of parties at different levels of development (although most exceptions in BITs are of a general nature and apply irrespective of the level of development of a country). These qualifications may apply to all substantive provisions and are particularly frequent with regard to the establishment of foreign investment and the repatriation of funds.

In sum, current BIT practice does not, in general, expressly deal with development matters. For most BITs concluded over the past decade, it remains true that, “a striking feature [...] is the multiplicity of provisions they contain that are specifically designed to protect foreign investments, and the absence of provisions specifically designed to ensure economic growth and development”.<sup>8</sup> The need is, therefore, for further clarification of the interrelationship between existing standards of investor protection and investment promotion, on the one hand, and the best means by which development concerns can be (or should be) expressed in the future evolution of BITs, on the other hand.

\* \* \*

In conclusion, the evolution of BITs during the last decade confirms a trend that had already become apparent in the previous review period. Countries share similar perceptions as regards the basic structure and content of these agreements. That having been said, BITs have become more diverse when it comes to the individual facets of investment promotion and protection. A small group of countries stand out with regard to treaty innovations; however, it is too early to say whether this trend will develop into a more general movement in the future.

More variation in BITs has its benefits but also gives rise to concern about policy coherence, in particular for developing countries. One consequence of this situation is the growing need for capacity-building to help developing countries in assessing the implications of different policy options before they

enter into new agreements, in identifying the potential obligations deriving therefrom and in implementing commitments made. Rigorous policy analysis of the evolution of the BIT universe and further international consensus-building on key development-related issues are other vital tasks. This includes more research on emerging trends concerning internationally recognized principles in investment rulemaking and the identification of common elements. International organizations can lend a helping hand in this regard.

### Notes

<sup>1</sup> It is difficult to define in detail the standard typology of a traditional BIT. For a detailed analysis of this typology, see UNCTAD (1998).

<sup>2</sup> In this regard, see subsection E.2.a.(i) above.

<sup>3</sup> For instance, general exceptions on taxation can be found in, inter alia, the BITs between Germany and Mexico (1998), Argentina and New Zealand (1999), Chile and New Zealand (1999), Hong Kong (China) and New Zealand (1995), Barbados and Canada (1996), Canada and Costa Rica (1997), Japan and Viet Nam (2003), and the United States and Uruguay (2005). General exceptions on the protection of natural resources can be found in, inter alia, the BITs between Mauritius and Switzerland (1998), Australia and India (1999), and Armenia and Canada (1997). General exceptions on public order and essential security interests can be found in, inter alia, the BITs between Finland and Kyrgyzstan (2003), Japan and the Republic of Korea (2002), Australia and India (1999), CARICOM and Cuba (1997), Croatia and India (2001), and Mozambique and the United States (1998).

<sup>4</sup> For example, the use of the exception for the protection of cultural diversity is practically limited to BITs negotiated by Canada and France.

<sup>5</sup> For instance, positive language enhancing the commitment of the contracting parties to enforce health and safety standards can be found in, inter alia, the BITs between Namibia and the Netherlands (2002), and Mexico and Switzerland (1995). Commitments for the protection of the environment can be found in, inter alia, BITs between Finland and Kyrgyzstan (2003), Mozambique and the Netherlands (2001), the 2004 Canadian model BIT, Japan and Viet Nam (2003), the Republic of Korea and Trinidad and Tobago (2002), the United States and Uruguay (2005), and Belgium–Luxembourg and Ethiopia (2003). Commitments for the protection on internationally recognized labour rights can be found in, inter alia, the BITs between Armenia and Austria (2001), Namibia and the Netherlands (2002), Finland and Nicaragua (2003), and Belgium–Luxembourg and Zimbabwe (2003).

<sup>6</sup> See subsection E.2.b (i) above.

<sup>7</sup> See UNCTAD (2002, para. 5.d (vi)).

<sup>8</sup> See Robinson (1998, p. 84).



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*Foreign Direct Investment in Africa: Performance and Potential*. 89 p. UNCTAD/ITE/IIT/Misc.15. Free of charge. Also available from <http://www.unctad.org/en/docs/poiteiitm15.pdf>.

*TNC-SME Linkages for Development: Issues–Experiences–Best Practices. Proceedings of the Special Round Table on TNCs, SMEs and Development, UNCTAD X, 15 February 2000, Bangkok, Thailand*. 113 p. UNCTAD/ITE/TEB1. Free of charge.

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## Studies on FDI and Development

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