Part I: Study on investment protection agreements as instruments of international economic law

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PART I: STUDY ON INVESTMENT PROTECTION AGREEMENTS AS INSTRUMENTS OF INTERNATIONAL ECONOMIC LAW

by Dr Pieter Jan Kuijper[1]

Abstract

This study seeks to set out briefly the historical background and the development of present-day Bilateral Investment Treaties (BITs) that have grown in sophistication and in number since the first one of this type of treaties was concluded between the Federal Republic of Germany and Pakistan in 1959. It explains how such BITs combined elements from the historical international law doctrine on the treatment of aliens and their property and investments and from commercial arbitration. A third, very important, element was the linkage of such agreements to international dispute settlement treaties or centres, which enabled foreign investors to complain directly against the host State, often even bypassing its law and its judicial system. The key provisions that are habitually included in such agreements are explained and briefly analysed. Next, the paper shows how trade and investment were closely linked in the drafts for the post World War II economic order, were allowed to develop separately and now are being integrated again into single comprehensive trade agreements, of which the budding Trans-Atlantic Trade and Investment Partnership (TTIP) between the EU and the US is an example. The complications flowing from bringing together trade and investment in one agreement, but needing two different dispute settlement procedures, are given a first analysis. Careful technical legal work is still necessary to guide this into the right channels. Is the effort needed for that worth the trouble, given that the EU and the US have been able mutually to accommodate huge flows of investments without provoking major conflicts or economic accidents? That question is given a tentative answer in the Conclusion. This study serves as background and primer to two other studies prepared for the European Parliament by professors Ingolf Pernice and Steffen Hindelang.

1. INTRODUCTION

Ever since the first Bilateral Investment Treaty was signed in 1959, these instruments of international law have spread far and wide throughout the world. Almost 3000 Bilateral Investment Treaties (BITs) were in existence at the end of 2013[2]. This impressive number serves as a first indication of the importance of BITs in a globalized economy. The present report aims to provide insight into the relevance, content and context of Bilateral Investment Treaties. In order to do so, section (II) will analyse the objectives and purpose of Bilateral Investment Treaties based on the history of their emergence. Section (III) will discuss the usual elements of contemporary BITs and shed some light on the main policy questions that are attached to the drafting of these treaties. Section (IV) will analyse the relationship between international trade law and international investment law and explain how investment law came to be intertwined with international trade law and policy (again). In section (V) we will discuss some potential procedural and substantial conflicts that are caused by the overlap between areas of trade law and

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[1] Prof. Dr Pieter Jan Kuijper, Professor of the Law of International Economic Organisations, University of Amsterdam. The author extends particular thanks to his assistant Martin Reuling for his invaluable support in researching this report. Without him the report could not have been finished in time. Many thanks are due for valuable comments on earlier drafts of this paper to my co-rapporteurs Ingolf Pernice and Steffen Hindelang and to Professor Makane Mbengue of the University of Geneva.

[2] UNCTAD, *World Investment Report 2013. Global Value Chains: Investment and Trade for Development* (2013), available at: http://unctad.org/en/publicationslibrary/wir2013_en.pdf (last accessed 21 March 2014), p. X.

areas of investment law. In section (VI) some light will be shed on how international investment law became a part of EU competences. In section (VII) we will make some concluding observations.

2. HISTORY AND OBJECTIVES OF BITS

2.1 Some short history

Even though the first Bilateral Investment Treaty was signed in the second half of the twentieth century, its roots can be traced back to the seventeenth century, when new formed nation-states entered treaties exempting their nationals from taxes and jurisdiction of their contracting party[3]. The Friendship, Commerce and Navigation treaties (FCN) that emerged in the second half of the eighteenth century and retained their importance until far into the twentieth century can be seen as the direct predecessors to BITs. These were general economic treaties concerning a broad range of topics[4].

The need for investment protection became more apparent during the nineteenth and early twentieth century in the light of conflicts between mostly Latin American states on the one side and Western-European states and the United States on the other side, concerning the applicable standard of protection for foreign investment or rather, as it was called at the time, the standard of treatment of aliens and their property. Latin American states adhered to the so-called *Calvo-Doctrine*, which was based on the assumption that aliens and their property should be subject to national treatment, that is to say that they should be treated in the same way as national investors, thus binding foreign investors to the domestic judicial systems of the receiving state and excluding external intervention or internationally defined minimum standards of treatment. At the same time Western European states and the US held that international law prescribed a so-called 'international minimum standard' that protected foreign investors from extremely low standards of national treatment and from domestic instabilities. Both theories collided vehemently in the wake of *coups d'état* and civil wars in Latin American states and of the 'socialization' of the factors of production by the Soviet Union following the Russian Revolution. During the 1920s, international jurisprudence by the Permanent Court of International Justice (PCIJ) and other tribunals established the minimum standard of treatment as an accepted principle of international law[5].

After a number of failed attempts throughout the twentieth century to reach a multilateral system of investment protection, Germany initiated the negotiation of specialised investment treaties on a bilateral basis. In 1959 this program would result in the conclusion of the first ever Bilateral Investment Treaty, in broadly the form that we know today, between the Federal Republic of Germany and Pakistan[6].

The German parliamentary history of this Treaty reveals the main objectives behind its conclusion. The 1959 Budget Act contained a provision allowing the Ministry of Finance to provide guarantees or (re-)insurance for German foreign investments, provided that an agreement concerning the treatment of

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[3] Jeswald W Salacuse, *The Law of Investment Treaties,* Oxford, Oxford University Press 2010, p. 83.

[4] Chester Brown, 'The Development and Importance of the Model Bilateral Investment Treaty', *in:* Chester Brown (ed.), Commentaries on Selected Model Investment Treaties, Oxford: Oxford University Press 2013, 1, p. 4.

[5] Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties*. *Standards of Treatment*, Alphen aan den Rijn, Kluwers Law International 2009, pp. 13-15. An important PCIJ case was: Certain German Interests in Polish Upper Silesia, Judgement of 25 May 1926, PCIJ Series A, No. 7. Considerable influence on the development and application of an international standard of treatment, especially as applicable in times of civil unrest and revolution, has been exercised in the nineteenth century by the Mexican Claims Commission and in the late twentieth century by the Iran-US Tribunal. These two institutions have each generated enormous quantities of case law.

[6] Treaty between the Federal Republic of Germany and Pakistan for the Promotion and Protection of Investments (signed 25 November 1959, entry into force 28 April 1962), 457 UNTS 23.

the investment had been concluded, or, absent such agreement, the legal system of the respective state sufficiently guaranteed the safety of the investment[7]. This provision would enable the German Government to foster development abroad through private investment[8]. The Government recalled this legal requirement of guaranteed safety of investments when it presented the BIT with Pakistan to the *Bundestag* in the same year. Stating that the adoption of this treaty would in itself fulfil the legal requirements of the relevant provision of the Budget Act, the Government added that this specialized investment treaty extended the economic aspects of the traditional FCN treaties and would at the same time create more favourable conditions for German investors in Pakistan[9]. The initial motives for the conclusion of the first BIT were thus, besides codification of customary law (as seen by Western capital exporting countries) and protection of legal interests of investors, 'predominantly' a consequence of the insurance and guarantee system for outward investment in the Federal Republic of Germany[10]. More generally, however, the asymmetrical relationship between investor states and host states (often developing countries) in these early years indicates that BITs were intended by investor states to protect investments of their nationals[11]. In spite of the conclusion of such treaties the precise content of the international minimum standard remained controversial throughout the 'sixties and the 'seventies. Especially in the United Nations General Assembly, the developing countries used their numbers and mounted an offensive *inter alia* against this standard in a series of resolutions on Permanent Sovereignty over Natural Resources, on the New International Economic Order and on Economic Rights and Duties of States. All these resolutions, each in their own way, emphasized national treatment, put in doubt the status of the international minimum standard and its contents, in particular the standard for compensation after nationalization[12].

On the other hand, perhaps in the present international economic system more than in 1959, there also seems to be a link between the extent to which developing countries are willing to conclude BITs and the credit ratings that these countries receive from the international rating agencies. An Austrian-Mexican expert on investment protection has recently pointed to this link as one of the reasons why Mexico for instance continued to conclude such agreements in spite of its not very favourable experience with for instance the NAFTA investment chapter. The possibility to borrow against an interest rate a few basis points lower than would otherwise be the case, in his view, explained Mexico's continued support for BITs[13].

Many Western-European states followed the example of Germany through the 1960s and 1970s, in part because of a wave of expropriations during the 1970s, while the USA followed in the 1980s. The dissolution of the Soviet-Union and the emergence of new market economies in Central and Eastern Europe, combined with the growing willingness of Latin-American countries to accept BITs led to a

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[7] Gesetz über die Feststellung des Bundeshaushaltplans für das Rechnungsjahr 1959 (German Budget Act 1959), (1959) 31 *Bundesgesetzblatt II*, 793, par. 18.

[8] Deutscher Bundestag (German Federal Diet), Entwurf eines Gesetzes über die Feststellung des Bundeshaushaltsplans für das Rechnungsjahr 1959 (Haushaltsgesetz 1959). Denkschrift (1 December 1958), Drucksache 03/650, pp. 6-7.

[9] Deutscher Bundestag (German Federal Diet), Entwurf eines Gesetzes zu dem Vertrag vom 25. November 1959 zwischen der Bundesrepublik Deutschland und Pakistan zur Förderung und zum Schutz von Kapitalanlagen. Denkschrift (15 February 1961), Drucksache 03/2495, p. 13.

[10] Justus Alenfeld, *Die Investitionsförderungsverträge der Bundesrepublik Deutschland*, Frankfurt am Main, Athenäum Verlag GmbH 1971, p. 17.

[11] Andrew Newcombe and Lluís Paradell, *op. cit.* fn. 5, at p. 43.

[12] UNGA Res. 1803 (XVII) Permanent Sovereignty over Natural Resources of 14 December 1962, point 4; UNGA Res. 3201(S-VI) Declaration on the Establishment of a New International Economic Order of 1 May 1974, point 4(e); and UNGA Res. 3281 (XXIX) Charter of Economic Rights and Duties of States of 12 December 1974, Article 2.

[13] View expressed by Herfried Wöss in a comment to Anne van Aken on the OGEMID blog on 23 March 2014 (last accessed 23 May 2014).

rapid proliferation of BITs. The number of BITs in existence would rise from less than 400 in 1989 to approximately 2400 in 2004[14].

2.2 BITs and dispute settlement centres

When the budgets of governmental aid programs stagnated in the second half of the 1950s, efforts were made to promote private investment in developing countries in order to foster development. Political and non-economic risks appeared to discourage investors to invest in developing countries[15]. Furthermore, investment disputes had been traditionally settled through interstate channels under diplomatic protection. This depended on the political will of a state to aid its nationals in case of problems with foreign investment and ultimately to espouse the claim of its nationals as its own[16]. Direct investor-state arbitration, making such espousal redundant, would only be included in BITs in the late 1960s. For this reason, during the late 1950s efforts were made to create a multilateral regime for the protection of private foreign investment, especially a mechanism of international investor-state arbitration.

In 1965, the OECD requested the World Bank to draft a Convention for an International Investment Insurance Agency. This did however not lead to the establishment of such Agency. As early BITs did not contain provisions on investor-state disputes the need for action continued to exist. Based on considerable experience the World Bank decided to continue to seek a solution for investor-state disputes, convinced that it would be easier to reach agreement on a procedure for dispute settlement than to reach agreement on international standards of treatment[17]. In 1961 the Bank began work on a Draft Convention for the Resolution of Disputes between States and Nationals of Other States[18]. Negotiations lasted until 1965 and the International Centre for the Settlement of Investment Disputes (ICSID) was created in October 1966[19]..

The Centre faced a slow start, as many developing countries were reluctant to accept third-party arbitration, rather insisting on their sovereignty and the competences of their domestic courts. The first BIT enabling ICSID arbitration was concluded in 1968[20]. In these early years ICSID developed considerable experience in appointing ad hoc arbitrators and aiding in conciliations. At the same time, it became a knowledge centre for foreign investment law. These early years allowed the Centre to build a reputation as a reliable centre of expertise. This reputation, combined with the large number of new BITs referring to ICSID arbitration during the 1980s and 1990s led to a growing importance and caseload of ICSID in subsequent years[21]. For the moment the ICSID Convention does not yet accept international organizations as parties. However the European Commission has declared that the EU should strive to become a party[22], which would necessitate an amendment to the ICSID Convention.

In the course of the spread of investment treaties, other centres for dispute settlement emerged. The Permanent Court of Arbitration (PCA) is by far the oldest of these and was founded in 1899, during the

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[14] Chester Brown, *op. cit. fn.* 4, pp. 9-10; Jeswald W Salacuse, *op. cit. fn. 3, at* p. 95.
[15] Antonio R. Parra, *The History of ICSID,* Oxford, Oxford University Press 2012, p. 12.
[16] Jeswald W Salacuse, *op. cit. fn. 3,* at p. 93
[17] Chester Brown, *op. cit. fn.* 4, at pp. 8-9.
[18] Antonio R. Parra, *op. cit. fn.* 16*,* at pp. 17-19 & 97.
[19] This was done by the Convention on the Settlement of Investment Disputes between States and Nationals of other States (signed 18 March 1965, entry into force 14 October 1966), 575 UNTS 159 ('ICSID Convention').
[20] Jeswald W Salacuse, *op. cit. fn.* 3, at p. 94.
[21] Antonio R. Parra, *op. cit. fn.* 15, pp. 121-122 & 200-209.
[22] European Commission, 'Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions. Towards a Comprehensive European International Investment Policy', (Communication), COM (2010) 343 final, *available at:* http://trade.ec.europa.eu/doclib/docs/2011/may-/tradoc_147884.pdf, p. 10.

first of The Hague peace conferences. It had already built considerable expertise in international arbitration between States prior to the conclusion of the first BIT. In the meantime the PCA has developed into an institution that provides registry services and administrative support in international arbitrations involving various combinations of states, state entities, international organizations and private parties. Thus there are PCA rules for Arbitration of Disputes between states or international organizations and private parties[23]. Important treaties, such as the Energy Charter Treaty, which contains an investment chapter, refer to the PCA as dispute settlement forum[24].

The Paris-based International Chamber of Commerce (ICC) developed a dispute settlement mechanism that became one of the most-used for the settlement of investment disputes. The London Chamber of Commerce created a Chamber of Arbitration in the nineteenth century that is nowadays widely known as the London Court for International Arbitration. The Stockholm Chamber of Commerce developed a similar institute, the Arbitration Institute of the Stockholm Chamber of Commerce. The Singapore International Arbitration Centre was founded in 1991 as an NGO.

All these initiatives and the arbitration rules they spawned originally were intended primarily for commercial arbitration, but their wording was, or has become, so general – referring to the two sides in an arbitral procedure merely as 'the parties' – that these facilities, just as the PCA, can also be used for investor-State arbitration (including investor-EU arbitration, if necessary)[25].

Lastly, attention needs to be drawn to the independent arbitration under the rules created by the United Nations Commission on International Trade Law (UNCITRAL). UNCITRAL originally concentrated its work entirely on private law and commercial arbitration. However, between the first version of its Arbitration Rules (1976)[26] and its latest version[27] there again occurred the same evolution as sketched above, namely that the wording expanded both as to subject matter of, and parties to, the dispute so as to encompass investor-State arbitration. In addition UNCITRAL has drafted recently important rules on transparency in treaty-based investor-State arbitration[28]. UNCITRAL does not include, as the PCA and the Chambers of Commerce initiatives referred to above, a registry and administrative support. Its rules are referred to in other agreements, including BITs, and can be used in procedures supported by ICSID, PCA and other arbitration centres.

Dispute Settlement under BITs thus occurs on the basis of two or three international law instruments: the substantive rules of the BITs, the Arbitration Rules of UNCITRAL and the services of arbitration centres; in many cases, however, the arbitration centres also provide the arbitration rules and it is not impossible to combine all three bases in one legal instrument, a single BIT or BIT-like treaty[29].

[23] See www.pca-cpa.org

[24] European Energy Charter Treaty, *Official Journal of the European Union – Law* (31 December 1994) L 380/24.

[25] Most documents concerning these arbitration rules can be found in Martins Paparinskis (ed.), *Basic Documents on International Investment Protection,* Oxford and Portland, Hart 2012, pp. 681 ff.

[26] UN Doc. A/Res/31/98 of 15 December 1976.

[27] UN Doc. A/Res/65/22 of 11 January 2011.

[28] Dated July 11, 2013, reprinted in 52 ILM 2013, p. 1300 ff.

[29] This is a road that is open to the EU as newcomer in the field of BITs and BITs arbitration, especially as an important instrument as ICSID is, for the time being, not open to it.

3. ELEMENTS AND OBJECTIVES OF CONTEMPORARY BITS

Even though differences exist between the exact content and wording amongst the nearly 3000 BITs that were in existence at the end of the year 2013, a certain set of provisions can be found at the core of contemporary investment treaties[30]. The preambles to such treaties provide valuable information about the object and purpose of BITs. For example, the Preamble to the 1959 Germany-Pakistan BIT stated that the object of the treaty was to intensify economic cooperation and create favourable conditions for foreign investment in order to 'increase the prosperity' of both states[31]. The preambles to modern BITs make it very clear that the object and purpose of BITs has shifted. While the 2008 Austrian Model BIT contains extensive references to investment as means of development, friendship between the peoples of the contracting parties, sustainability of economic growth, corporate responsibility, respect for human rights, anti-corruption efforts, the UN Global Compact and other values, most contemporary BITs barely mention development as an objective[32]. For example, the preamble of the 1997 Sweden-Turkey BIT mentions intensified economic cooperation, fair and equitable treatment and expansion of economic relations as only objectives[33]. This move away from development as objective can partly be explained by the fact that BITs are increasingly concluded between states of comparable levels of development.[34] Another trend that has acquired new prominence is the wish to achieve the objectives of BITs "in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights".[35] As we will see below, the protection of such regulatory powers is also strongly influenced by the clarity and precision of the provisions on Fair and Equitable Treatment (FET) and on indirect expropriation.

Pursuant to their main objectives, stimulating foreign investment through legal certainty, and promoting economic development in the host state and, more generally, the economic relations between states, the substantial provisions of BITs can be roughly divided into two interrelated, sometimes overlapping categories[36]. The first category of provisions is aimed at enabling access of foreign investors to the host state and preventing discriminatory measures, by prescribing conditions for entry of foreign investment, and standards of treatment (i.e. non-discrimination). The second category of substantial obligations consists of investment protection clauses, including rules on nationalisation. Formal or procedural provisions guarantee investors legal redress through the judicial system of the host state and/or international arbitration. If one looks at the most recent draft of the Investment Chapter of CETA, the Comprehensive Economic and Trade Agreement between the EU and Canada, the sections are (1) Scope and Definitions, (2) Establishment of Investments, (3) Non-

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[30] Naboth van den Broek, 'Protection of Investors in International Trade and Investment Regime: A Practical Comparison', in: Jorge Huerta-Goldman, Antoine Romanetti and Franz Stirnimann (ed.), WTO Arbitration, Investment Arbitration, and Commercial Arbitration, Alphen aan den Rijn: Kluwer Law International 2013, 15, p. 23; Jeswald W Salacuse, *op. cit. fn.* 3, at p. 138; UNCTAD, *op. cit. fn. 2,* at p. X.

[31] Treaty between the Federal Republic of Germany and Pakistan for the Promotion and Protection of Investments (signed 25 November 1959, entry into force 28 April 1962), 457 UNTS 23.

[32] August Reinisch, 'Austria', *in:* Chester Brown (ed.), Commentaries on Selected Model Investment Treaties , Oxford, Oxford University Press 2013, 15, p. 20.

[33] Agreement Between the Kingdom of Sweden and the Republic of Turkey on the Reciprocal Promotion and Protection of Investments (signed 11 April 1997, entry into force 8 October 1998) 2313 UNTS 159.

[34] There even is an example of a multilateral investment agreement concluded between developing countries only: the Investment Agreement for the COMESA Common Investment Area (2007), not yet in force, see http://www.tralac.org/wp-content/blogs.dir/12/files/2011/uploads/Investment_agreement_for_the_CCIA.pdf.

[35] See the fifth preambular paragraph and Articles 12 and 13 of the 2004 US Model BIT, in Martins Paparinskis (ed.), *op. cit. fn. 26,* at p. 526.

[36] Tarcisio Gazzini, 'Bilateral Investment Treaties', *in:* Tarcisio Gazzini and Eric de Brabandere (ed.), *International Investment Law. The Sources of Rights and Obligations,* Leiden/Boston: Martinus Nijhoff Publishers 2012, 99, pp. 106-107.

discriminatory Treatment, (4) Investment Protection, (5) Reservations and Exceptions, (6) Investor-State Dispute Settlement and (7) Final Provisions[37].

This section will now discuss the most important provisions of each category, and analyse their relevance and relation to other provisions. This discussion will be based on the text of so-called Model Treaties[38] that have been issued mostly by developed countries as well as on provisions of actually existing Bilateral Investment Treaties. Technical provisions, such as those containing rules on entry into force, amendment etc. and which are based on general rules of the law of treaties, will therefore not be discussed here, except insofar as they deviate from what is considered normal in treaty practice.

3.1 Definitions

As Bilateral Investment Treaties are international agreements in the sense of the 1969 Vienna Convention on the Law of Treaties, their contractual nature requires clear definition of the scope of the agreement and the obligations it will entail[39]. This necessitates careful definition of the transactions and actors that fall within the scope of protection of the treaty, in order to avoid legal uncertainty. Already the first BIT, concluded between the Federal Republic of Germany and Pakistan in 1959, contained a provision with definitions of terms as 'investment', 'returns' and 'nationals'[40].

For example, capital-exporting countries will seek to draft the definition of 'investment' that is covered by the BIT very broadly, since economic activities falling outside of the scope of this definition are not protected under the terms of the BIT. For this reason, investment is in many BITs defined as 'any kind of asset' and illustrated with a non-exclusive list of examples. Critics of overly broad definitions submit that certain investments, such as financial instruments that contribute to a currency crisis or that entail other detrimental effects, should be excluded from the protection of a BIT. Furthermore, overly broad definitions of investment could limit the regulatory competences of governments. Careful definition of 'investment' is thus crucial[41].

Another definition that is of great importance is that of 'national of a Party' or 'investor of a Party'. This definition determines who can invoke the protection of a BIT. For instance, the definition of the term 'Nationals' in the Dutch Model BIT and in most actual Dutch BITS is drafted so that, if a US company organizes its structure in such a way as to have its overseas subsidiaries attached under a Dutch so-called financial centre of that company[42], BITs claims concerning the treatment of the overseas subsidiaries can be made by the Dutch financial centre on the basis of the Netherlands BIT with the

[37] The most recent public version of the CETA investment chapter, from April 2014, can be found in a paper published by the European Commission on the occasion of the consultation on the investment rules of the TTIP, European Commission, Note for the Attention of the Trade Policy Committee (Services and Investment). EU Canada FTA Negotiations: Investment Chapter, Trade B2/CBA/cg/Ares 1151153 (7 April 2014).

[38] Such Model Treaties have gone through different so-called generations. We have done our best in the following to use Model BITs from the latest generation.

[39] Tarcisio Gazzini, *op. cit. fn.* 37, at p. 106.

[40] Treaty between the Federal Republic of Germany and Pakistan for the Promotion and Protection of Investments (signed 25 November 1959, entry into force 28 April 1962), 457 UNTS 23, art. 8.

[41] Kenneth J Vandevelde, *Bilateral Investment Treaties. History, Policy and Interpretation*, Oxford: Oxford University Press 2010, p. 122 ff. See also the Dissenting Opinion of Georges Abi-Saab in *Abaclat v. Argentina*, para. 57, in which he casts aspersion on the protection as an investment of government bonds, which he describes as 'widely dispersed financial products with their high velocity of circulation and their remoteness, the same as their holders, from the State in whose territory the investment is supposed to take place', which 'seem at first blush to be worlds apart from the direct foreign investment model, which is usually long negotiated and extensively embedded in the legal environment of the host State', ICSID Case ARB/07/5

[42] Note that having a so-called financial centre in the Netherlands does not require a large lay-out in money and personnel, but can be fiscally highly attractive.

country hosting the overseas subsidiary in question[43]. This is so-called 'BITs hopping' and permits large multinational companies, even with a minimum of activities in the Netherlands, to have access to a large number of BITs that a small country with a mid-size economy and a good reputation in the field of development aid has been able to conclude with many developing countries[44].

3.2 Access and standards of treatment: two models

The access for foreign investments to the host state can be regulated pursuant to two models. The first model contains no specifically defined obligations for the state parties and leaves entry and regulation of foreign investment to the discretion of each state. The states enter no specific obligations concerning access, entry and establishment. In this case a provision will often declare that state parties undertake to create 'favourable conditions' for foreign investment 'in accordance with the laws and regulations' of each state. This model, which is often referred to as the 'admission model' or 'investment-control model', does not influence existing legislation and will thus be easier to agree upon. Parties retain a broad competence to control and regulate the access of foreign investment. Such broad provisions are more of an aspirational character and thus create little concrete and enforceable obligations. A vast majority of existing BITs still adheres to this approach[45].

The other model of access consists of a combination of treatment standards that serve as thresholds to foreign investors. The exact combination and wording of applied standards varies per treaty, but their goal is always to guarantee the highest attainable standard of treatment for foreign investors.

3.2.1 National treatment (NT)

National treatment clauses guarantee foreign investors that fall within the scope of the BIT treatment no less favourable than domestic investors[46]. The phrase 'no less favourable' is of crucial importance, since it signifies that states are not obliged to give foreign investment exactly equal treatment to domestic investment. As long as any differences in treatment do not create any burdens that disadvantage foreign investors in comparison to domestic investors, states are allowed to treat foreign investors differently from domestic investors. National treatment provisions prohibit discrimination based on the nationality of the investor and ensure equal competitive opportunities of both foreign and domestic investors[47]. This standard can be limited to the post-establishment phase in order to grant the host state more control over the entry of investment, or it can be extended also to the pre-establishment phase, thus improving accessibility for foreign investors.

National treatment can be extended or limited by using either a positive list or a negative list, which demarcates the categories of investment that benefit from national treatment[48]. A relatively new way of limiting national treatment is to prescribe that it applies to investors and to investment of those investors of the capital exporting country, only if they are in "like situations (or circumstances)" as those of investors or their investments of the host State. This creates opportunities to discriminate for regulatory purposes, if it is arguable that the situation of the foreign investors is not "like" that of the

[43] On this phenomenon see Roos van Os and Roeline Knotnerus, *Dutch Bilateral Investment Treaties. A Gateway to 'Treaty-Shopping' for Investment Protection by Multinational Companies*, Amsterdam SOMO 2011 and Timothy G. Nelson, Going Dutch – the Many Virtues of the Dutch Model BIT, 6 (2012) 2 Dispute Resolution International, 161.
[44] The Netherlands has over 90 BITs with many different countries. Many cases brought on the basis of Dutch BITs have been started by foreign companies with limited activity in the Netherlands, a well-known example being *Aguas de Tunari SA v. Republic of Bolivia*, ICSID Case ARB 2/03.
[45] August Reinisch, *Standards of Investment Protection,* Oxford, Oxford University Press 2008, at p. 11.
[46] Naboth van den Broek, *op. cit. fn.* 30, at p. 24.
[47] Andrew Newcombe and Lluís Paradell, *op. cit. fn.* 5, at p. 151.
[48] August Reinisch, Standards of Investment Protection, op. cit. fn. 45, at p. 13.

national investors[49]. States have historically been rather reluctant to accept national treatment clauses as they limit their ability to protect domestic industries through subsidies and other instruments. This has led to a great variety in formulation of such clauses[50]. The national treatment standard is a comparative standard, which means that it only links foreign investment protection to that of domestic investors but does not contain any substantive rules that the host State has to observe. For this reason, BITs often also contain a number of more substantial standards, which will be discussed in the following sections[51].

3.2.2 Most-favoured nation clauses (MFN)

Most-Favoured Nation clauses prohibit discrimination between foreign investors from different countries. Under these clauses, states are obliged to apply to investors from the state party a treatment standard that they granted investors from a third state, if that standard would be more favourable to foreign investors from the state party. Most-Favoured Nation treatment creates parity of treatment amongst foreign investors and serves as an insurance against (involuntary) errors or shortcomings in specific BITs as compared to other BITs[52]. Like national treatment, it is a comparative standard with no substantive content of its own. National treatment and most-favoured nation treatment combined serve to maintain a level playing field on the investment market of a country as between all foreign and national investors.

3.2.3 Minimum Standard and Fair and Equitable Treatment (FET)

While national treatment and most-favoured nation clauses contain obligations that are shaped by comparison with domestic or third-state investors, the so-called minimum standard contains obligations whose content is not determined by such comparison. This minimum standard of treatment is widely claimed to be part of customary international law (at least in western countries)[53]. It may contain elements of the following specific categories of clauses to be found in BITS. The first commonly recognized category refers to the customary law on treatment of aliens and their property, which sometimes takes the form of a mere reference to customary international law[54]. This is not a clause that one continues to see frequently in BITS of the newer generations

Secondly, the principle of fair and equitable treatment (FET) can serve as a broad clause that may be applied in cases that are not covered by clear rules of law. The principle contains a broad category of general standards and principles that allude to non-discrimination and the rule of law. It has been argued that the current case law on the notion of FET shows up the following recurrent elements derived from well-known legal principles: good faith; legitimate expectations, both with respect to the state of the law of the host country and its application, as well as in direct contacts between a foreign investor and the host state authorities (representations, contractual links, regulatory actions); due process, transparency, freedom from official harassment and even coercion, absence of arbitrary or

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[49] Article X.7.2 of the draft CETA applies this restricted version of national treatment to investment at the provincial level in Canada and to the Member State level in the EU. The full national treatment applies only at the federal, respectively the Union level, see Article X.7.1 draft CETA, *loc. cit*. fn 37. Both the US and Canada are presently experimenting with this restriction of national treatment in recent BITs or comprehensive trade and investment agreements. See also Article 17 Investment Agreement for the CCIA, *loc. cit* fn. 34

[50] Jeswald W Salacuse, *op. cit. fn.* 3, at p. 246.

[51] Andrea K. Bjorklund, 'National Treatment', *in:* August Reinisch, *Standards of Investment Protection,* Oxford, Oxford University Press 2008, 29, at p. 31. See below section iii, iv,v and vi and the so-called protection clauses, discussed in 3) below.

[52] Andrew Newcombe and Lluís Paradell, *op. cit. fn.* 5, at p. 195.

[53] Jacob Stone, 'Arbitrariness, the Fair and Equitable Treatment Standard, and the International Law of Investment', 25 (2012) Leiden Journal of International Law 77, 82.

[54] Andrew Newcombe and Lluís Paradell, *op. cit. fn.* 5, at p. 234.

xenophobic treatment by the authorities[55]. Some of these elements of FET are often mentioned separately in BITs, whilst other BITs limit themselves to mentioning that the parties shall treat foreign investments fairly and equitably[56]. On the other hand, CETA attempts to define FET by *exhaustively* listing such elements and thus takes an important step forward.[57]. Some BITs go so far as to use FET as a kind of container concept that even includes a combination of NT and MFN; this is a clause that uses the phrase 'treatment not less favourable than' treatment accorded to its own nationals' investments and to investments of nationals of third States (so-called TNLF clause)[58].

Clauses on the standard of full protection and security are normally directly linked to FET clauses. The former entail a positive obligation of state parties to ensure the safety of foreign investment through its laws, policy and conduct, including law enforcement measures[59]. Moreover, BITs can contain standards for compensation in case of extraordinary losses resulting from damages due to war or revolutionary events (see below 3.3.2).

Fair and equitable treatment can be either included in minimum-standards provisions, or it can be stipulated in a separate article[60]. The exact relation between both standards is subject of considerable debate. Especially developing countries have often insisted that fair and equitable treatment contains no additional rights in comparison with the minimum standard[61]. The exact relationship between both standards often only becomes clear in the course of arbitration[62]. Whether seen as a part of the minimum standard or treated as a separate threshold, the term fair and equitable treatment refers to the same group of principles that are widely seen as part of customary law. In order to achieve greater certainty about the precise content of the notion of FET, it is highly commendable to follow the precedent set by the CETA chapter on investment and to list exhaustively the elements that constitute FET.

It is clear that many of the aforementioned standards and provisions are strongly interrelated or even interdependent. It is however crucial to appreciate them as distinct instruments. The combination of included standards of treatment depends on political agreement between the parties to a BIT.

3.2.4 Umbrella Clause

The term umbrella clause is used to indicate provisions in a BIT that aim to include private law obligations contracted between the investor and the authorities of the host state within the protection

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[55] Rudolf Dolzer, 'Fair and Equitable Treatment: Today's Contours', 12 (2013) Santa Clara Journal of International Law, 7, pp. 16-31.

[56] This is for example the case in the German Model BIT. Article 2(2) provides that the contracting states shall accord foreign investors from the other contracting state 'fair and equitable treatment as well as full protection under this treaty'. Article 2(3) prohibits discriminatory or arbitrary measures, but the document does not provide more information on the content of these standards. See Rudolf Dolzer and Yun-i Kim, 'Germany', *in:* Chester Brown (ed.), *Commentaries on Selected Model Investment Treaties*, Oxford, Oxford University Press 2013, p. 287, pp. 306-310.

[57] See Article X.9 (2) of the CETA Draft as published by the European Commission, *op. cit. fn. 37*. The elements mentioned are: denial of justice, fundamental breach of due process; manifest arbitrariness; targeted discrimination on such suspect grounds as race, gender, and religion; and abusive treatment of investors, such as coercion, duress and harassment. Finally the Parties may agree on other elements of conduct that may constitute FET.

[58] See Article 3(2) 2004 Netherlands Model BIT. Such TNLF clauses also occur in other BITs, but not necessarily as part of an FET article.

[59] Naboth van den Broek, *op. cit. fn.* 30, at p. 27.

[60] Jorge Huerta-Goldman, Antoine Romanetti and Franz Stirnimann, *WTO Arbitration, Investment Arbitration, and Commercial Arbitration*, Alphen aan den Rijn, Kluwer Law International 2013, p. 26.

[61] Jeswald W Salacuse, *op. cit. fn.* 3, at p. 223. See Article 14 of the Investment Agreement for the CCIA, loc. cit. fn. 34, which states that FET shall be granted in accordance with international customary law, which is reduced to a prohibition of denial of justice in accordance with the principle of due process.

[62] Jacob Stone, *op. cit. fn.* 54, at p. 82.

of the BIT. Such private law obligations are often included in outright investment contracts, but also in side contracts linked to the unilateral acts of public authority that accompany the first investment by a foreign investor in the host State. More generally, conflicts between a foreign investor and the host State encompass not just government acts that allegedly breach the government's obligations to respect such principles as NT and MFN or FET, but often breach private law contractual obligations as well. In such a situation it is important for the foreign investor to be able to bring the whole of the conflict directly to international arbitration and not to have to differentiate between the public law and private law aspects of the dispute.

Many umbrella clauses, however, are drafted very broadly[63] and can be interpreted so as to bring every small contractual obligation of the government under the protection of the BIT, raise its breach to the level of a breach of the treaty and take it out of the jurisdiction of the local courts of the host State. And they have indeed been so interpreted[64]. At almost the same time other investment tribunals took a radically opposed viewpoint, arguing that such a broad interpretation would constitute so much of an inroad on the sovereignty of States that it was implausible[65]. It would seem that in the meantime other cases have been decided, which have found a reasonable equilibrium between these two extremes, largely based on whether the host State acted in a 'sovereign' capacity or as a 'market participant' in concluding the contract of which the breach is alleged. And yet the umbrella clause remains controversial and its interpretation still somewhat unsettled[66]. This unsettled nature is reflected in the draft text of the investment chapter of CETA: Canada did not propose any text for an umbrella clause, whilst the EU proposed a rather classical umbrella clause, emphasizing however that any breach could only result from the exercise of governmental authority.[67]

3.2.5 Free Transfer of Capital and Free Transfer of Funds

Besides assuring the highest possible standard of treatment, the right to freely transfer capital is of crucial importance to investors. Without this freedom, investors might not be able to set up and maintain their investments, withdraw their capital from the host state if need be, or repatriate the income over their investment[68]. For this reason, investor states often seek to assure the greatest possible freedom of transfer for their investors. Investment receiving states are however usually reluctant to grant unlimited freedom of transfer, fearing that sudden large capital movements might negatively influence their foreign exchange reserves and economies[69]. For this reason, most BIT provisions concerning transfer of capital define the right of foreign investors to transfer their capital, clarify the payments that fall within this freedom, and provide applicable currencies and exchange rates and the term within which investors must be allowed to make such transfers[70].

[63] See, for instance, Article 3(4) of the BIT between the Netherlands and the Czech and Slovak Republic: ' Each Contracting Party shall observe any obligation it may have entered into with regard to the investments of investors of the other Contracting Party.' Martins Paparinskis (ed.), *op. cit. fn. 26*, at p. 58.

[64] See *Noble Ventures v. Romania,* Award 12 October 2005, ICSID Case No. ARB/01/11, paras 50-62.

[65] See SGS v Pakistan, Decision on Jurisdiction, 6 August 2003 42 ILM (2003), 1290.

[66] For further detail on the relevant cases see Rudolph Dolzer and Christoph Schreuer, *Principles of International Investment Law,* Oxford, Oxford University Press 2008, 153-162.

[67] See Article X. of the CETA, placed between X:9 and X:10. Draft as published by the European Commission, *op. cit. fn. 37*

[68] Andrew Newcombe and Lluís Paradell, *op. cit. fn.* 5, at p. 399.

[69] Jeswald W Salacuse, *op. cit. fn.* 3, at p. 259.

[70] *Ibid.*, at p. 134. An example of a rather simple clause of this nature is Article 5 of the Agreement on Encouragement and Reciprocal Protection of Investments between Venezuela and the Netherlands 1991; a very complete version of such an article is contained in Article 7 of the 2012 US Model BIT, *available at:* http://www.state.gov/documents/organization/-188371.pdf (last accessed 8 June 2014).

The right of investors to move their financial assets freely out of the host State is also linked to the right to prompt, adequate, and effective compensation. If an investor is expropriated and subsequently denied the right to move the financial compensation at his own discretion, the money becomes hostage to the host state and will in effect be lost to the investor. To avoid such situations, clauses guaranteeing the free movement of capital are of great importance to the protection of foreign investment. Free transfer of compensation for nationalization is however a widely featured aspect of the free transfer clauses in BITs[71].

3.3 Protection Clauses

Access and standard of treatment clauses guarantee foreign investors that they can act as freely and receive treatment as favourable as possible. This ensures an unhindered flow of capital. When investors invest in another state, they subject their capital to the jurisdiction of the host state. This requires investors to carefully consider the risks that such investment brings. Doubts about the security of investments or their value might cause investors to refrain from such transactions. Confidence of foreign investors in the security of their investments is thus crucial for states that seek to attract foreign investment. On the other hand, investor states have a large interest in seeing the investments of their nationals protected, as sudden loss of foreign investment might have negative consequences on the economy of the host state. There are a number of situations in which the standards of treatment were not seen as sufficient security. These situations were seen as such risks to the value of foreign investment that they required extensive regulation in separate provisions. Such provisions are called investment protection clauses. They regulate a vast array of potential situations, from direct and indirect nationalisation to war and national disasters. It is however not correct to say that protection clauses are always necessary to attract foreign investment. Brazil and the United Kingdom have attracted considerable foreign investment without entering into protection clauses, or even without concluding great numbers of investment treaties in the first place[72]. The most common elements of these protection clauses will be discussed in the following paragraphs.

3.3.1 Nationalisation and Expropriation

Nationalisation of complete sectors of industrial production or of specific services, notably health services, was widely resorted to throughout the twentieth century.[73] Governments often defended such practices by claiming that they had not violated their obligations to provide national treatment to foreign investors, thus dismissing investor state claims that nationalisations violate the international minimum standard of treatment[74]. Under customary law, states are obliged to pay compensation when they expropriate foreign nationals[75]. The disagreement concerning nationalization caused investor states to seek inclusion of more elaborate treatment and protection systems in their BITs relative to individual expropriation.

Such protection clauses need to clearly define three matters. First, it is important to define which property is protected against expropriation. For this reason it is of crucial importance that the aforementioned definition clauses contain clear and inclusive definitions of the term investment.

[71] Andrew Newcombe and Lluís Paradell, *op. cit. fn.* 5, at p. 378.
[72] Surya P. Subedi, *International Investment Law. Reconciling Policy and Principle,* Oxford/Portland, Hart Publishers 2008, p. 86.
[73] Nationalization is used here as the term that designates the mass phenomenon of bringing a whole economic or industrial sector under State control, whereas the term expropriation will be used for individual acts of State appropriation of private property.
[74] Jeswald W Salacuse, *op. cit. fn.* 3, at p. 286.
[75] Andrew Newcombe and Lluís Paradell, *op. cit. fn.* 5, at p. 322. This is an obligation that in many States is rooted in the "right to property"; in Europe this is laid down in Protocol I to the ECHR and in Article 17 of the Charter of Fundamental Rights of the European Union.

Second, it is crucial to clearly define against which actions by governments foreign investment is protected. In other words, it is of paramount importance to define which acts amount to expropriation[76]. Third, expropriation protection clauses need to prescribe a standard of compensation for situations in which individual expropriation or nationalisation of a sector cannot be avoided[77].

Foreign investment needs to be protected against both direct and indirect expropriation. Direct expropriation is easy to understand and consists of a total expropriation of foreign investors, with an attendant loss of title of foreign investors[78]. Direct expropriation normally is required to be imposed in the public interest, by law, on a non-discriminatory basis and subject to compensation in order to be BIT-consistent. Indirect expropriation refers to a broad category of government measures which *de facto* nullify or impair the property rights of the investor, not necessarily leading to a loss of title. This may result in a partial or total loss of the value of the investment[79]. Such indirect expropriation can take the form of disproportionate tax increases, revocation of government permits and licenses, interference with contractual rights, etc. The large number of situations that might amount to indirect expropriation requires a broad definition of the term[80].

At the same time it is crucial to distinguish between measures that amount to indirect expropriation or nationalisation and those that are part of the legitimate competences of a state to regulate production and trade. A recent example of conflict between governmental regulatory powers and the interests of foreign investors is the arbitration between Swedish power company Vattenfall AB and the Federal Republic of Germany, in reaction to the 2011 amendment to the German Nuclear Energy Act. The Amendment provides for the immediate closure of several power plants and a staged closure of all German nuclear power plants until the year 2022 as a reaction to the Fukushima nuclear accident[81]. Vattenfall, which, after a recent acquisition of a German power company, operates two nuclear power plants that were to be closed pursuant to the new Act, requested proceedings at the International Centre for the Settlement of Investment Disputes (ICSID) on the basis of the Energy Charter Treaty. An arbitral tribunal was constituted in December 2012. Proceedings are currently pending, but remain as yet confidential[82]. This case demonstrates that it is of paramount importance that nationalisation protection clauses guarantee both sufficient respect for the deliberate exercise of governmental regulatory powers in the public interest, but also provide a reasonable measure of protection of foreign investment against direct and indirect expropriation resulting from abrupt changes of policy.

Again the draft chapter on investment from CETA contains a commendable attempt to contain the concept of indirect expropriation within reasonable bounds and thereby protects the right to regulate. First, Article X:11(2) indicates which factors must be assessed before an arbitral panel can arrive at the conclusion that there is a case of indirect expropriation[83]. Secondly, paragraph 3 of the same provision

[76] Jeswald W Salacuse, *op. cit. fn.* 3, at p. 291.
[77] Andrew Newcombe and Lluís Paradell, *op. cit. fn.* 5, at p. 322. See para. III.3.iii below on compensation.
[78] Jeswald W Salacuse, *op. cit. fn.* 3, at p. 294.
[79] Andrew Newcombe and Lluís Paradell, *op. cit. fn.* 5, p. 325. For an example of definitions of direct and indirect expropriation see Annex B of the US Model BIT 2012 *loc. cit. fn.* 70.
[80] Naboth van den Broek, *op. cit. fn.* 30, at p. 24.
[81] 13. Atomgesetz-Änderungsgesetz (Thirteenth Amendment to the German Atomic Energy Act) (2011), *Bundesgesetzblatt I*, 1704.
[82] Vattenfall AB and others v. Federal Republic of Germany, ICSID Case No. ARB/12/12. In the same case Vattenfall has joined German energy companies E.ON and RWE in constitutional cases before the Bundesverfassungsgericht, see cases 1 BVR 2821/11, 1 BVR 321/12, and 1 BVR 1456/12. Proceedings are currently still pending.
[83] Draft as published by the European Commission, *op. cit. fn 38.* These factors include: the economic impact and duration of the measures; the degree of interference with reasonable investment-backed expectations; and the object, context and intent of the measures.

states that measures designed and applied to protect legitimate public welfare objectives, such as health, safety, and the environment do not constitute indirect expropriations.[84]

3.3.2 War, National Emergencies and Civil Unrest

Numerous BITs contain provisions concerning compensation for damages to foreign investment as a result of war, national emergencies or civil unrest. Such provisions usually guarantee foreign investors the same rights to compensation as a Government might grant its domestic investors, thus ensuring compensation on an equal base. Such cases may also entail state liability for loss of or damage to foreign investment caused by the national armed forces[85]. The second situation led to arbitration in 1987, when a Hong-Kong based company claimed compensation from the Sri Lankan Government under the UK-Sri Lanka BIT for damages caused to one of its factories during a 1987 military operation against Tamil insurgents[86].

3.3.3 Compensation

Since nationalisation cannot always be avoided under all circumstances, most provisions allow nationalization under strict conditions, such as the existence of a situation of necessity or for reasons of public interest, the fulfilment of due process obligations and the payment of compensation[87]. The regime of compensation is particularly important. Guaranteeing investors equitable compensation will attract investment and protect investing states from the negative consequences of expropriations of its nationals.

Obtaining compensation that covers the losses caused by the expropriation within a reasonable period of time and in a way that allows investors to use and benefit from the compensation is crucial. For this reason, the often applied 'Hull formula' prescribes that compensation must be prompt, adequate, and effective. 'Prompt' means that the requirement that compensation follows in due course. 'Effective' refers to the nature of the compensation, which should be offered in directly transferable currency that allows immediate use of the compensation sum. 'Adequate' defines the amount of compensation paid, and is in many BITs linked to the market value of the investment before nationalisation.

Especially this last qualification of the compensation is subject to considerable debate. Most jurisprudence and doctrine and a large number of investment treaties point towards the fair market value of the investment as the applicable standard of compensation. Most compensation regimes also provide for the payment of interest on compensation, which is often due from the day of the expropriation onwards[88].

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[84] *Ibid,* Article X:11(3).
[85] M. Sornarajah, *The International Law on Foreign Investment (Third Ed.),* Oxford, Oxford University Press 2010, p. 213. An example of such a clause is Article 5(3) of the 2004 French Model BIT, in: Martins Paparinskis ed., *op. cit.* fn. 25, 552 ff.
[86] Asian Agricultural Products Ltd v. Sri Lanka, ICSID Case No. ARB/87/3.
[87] Andrew Newcombe and Lluís Paradell, *op. cit. fn.* 5, at pp. 375-377. For an example Article 5(1) of the 2008 UK Model BIT, in: Martins Paparinskis ed., *op. cit*. fn 26, 576 ff.
[88] Jeswald W Salacuse, *op. cit. fn.* 3, at pp. 323-324 & 396. For a good example of a clause containing such rules: Article 5 of the 1975 Agreement between the UK and Egypt for the Promotion and Protection of Investments, in: Martins Papaprinskis (ed.), *op. cit. fn 25*, 582 ff.

3.3.4 Continued Protection after Termination or Expiration of a Treaty

Most BITs contain provisions that extend their protection over investments made while the treaty was in force over a defined period after termination or expiration of the Treaty[89]. It is important in this context to distinguish between the expiration and termination of a Treaty. While many BITs are agreed for a predetermined period of time and thus expire after that period has passed, termination is usually a unilateral act by one of the parties to end the contractual relation between both states while the treaty is still in force.

In case of termination of a treaty, the period over which protection is extended is usually set between 10 and 20 years following termination[90]. These provisions guarantee that termination of the Treaty will not immediately affect the security of foreign investments and thus limit the political risks of foreign investment. This continued protection is especially important in light of the nature of foreign investments, which usually consist of a long-term presence of the investor in the host state that only becomes profitable after a number of years[91].

The prolongation of investment protection for a considerable period of time even after termination of the Treaty is a clear deviation from the standard norm laid down in the 1969 Vienna Convention on the Law of Treaties, which prescribes that parties are released from obligations stemming from the Treaty pursuant to its termination and only prohibits retroactive consequences of a treaty's termination[92]. In the succession between the Member States' BITs and new EU Investment Protection Agreements, the question arises to what extent these prolongation of protection clauses are extinguished by this succession, in view of the fact that the new EU agreement is likely to have a comparable clause.

3.4 Dispute settlement clauses

In case a dispute arises between states and foreign investors about a matter falling under a BIT, parties can resort to dispute settlement. Most BITs create a facetted system of dispute settlement reaching from consultations to domestic judicial settlement and international arbitration. An important difference between investment disputes and trade disputes is that trade disputes usually arise between two sovereign states, whilst investment disputes most commonly occur between private investors and states. Normally this entails that the private (foreign) investor has to turn to the courts of the host State, when a dispute arises between him and the host state authorities about the investment. In case of investor-state disputes, BITs usually grant access to the domestic legal system, and sometimes prescribe that investors need to exhaust all domestic remedies before resorting to international arbitration. Over the years, however, developed countries have sought to grant their investors direct access to international arbitration[93]. In modern BITs one hardly finds a full exhaustion clause any longer; if there is an obligation to turn to the national courts first, this is normally linked to a maximum period. If after that period the dispute is still on-going, it shall be brought to an international arbitral tribunal[94]. Indeed,

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[89] See, for example, Article 13 of the France-Argentina Agreement on the Promotion and Protection of Investments provides that after 'expiry of the validity of this Agreement, investments made while it was in force shall continue to be protected by its provisions for an additional period of 15 years. See Martins Paparinskis (ed.), *op. cit fn.* 26*,* 621.

[90] Andrea Carska-Sheppard, 'Issues Relevant to the Termination of Bilateral Investment Treaties', 26 (2009) 6 Journal of International Arbitration, 755, 763.

[91] Robert Ginsburg, 'Political Risk Insurance and Bilateral Investment Treaties: Making the Connection', 14 (2013) 6 Journal of World Investment & Trade 943, 947.

[92] Compare Vienna Convention on the Law of Treaties (signed 23 May 1969, entry into force 27 January 1980), 1155 UNTS 331, Article 70 As is usual in the Vienna Convention, parties to a treaty can always deviate from the rules of the Convention – which they have done in the most emphatic manner in most BITs.

[93] Surya P. Subedi, *op. cit. fn.* 73, at p. 18.

[94] An example of such a clause is Article 10(2) and (3) of the Agreement between Germany and Argentina on the Encouragement and Protection of Investments 1991, in Martins Paparinskis, *op. cit. fn* 25, 604 ff.

stimulated by the evolving provisions of BITs in this respect, there has been a development, moving away from domestic courts as principal forum for dispute settlement towards direct access to international arbitration as the most important way of solving investment conflicts[95]. There are three reasons for this development.

First, the practice of espousal of claims, in which governments take over an investment claim of their nationals against another State after they have exhausted all local remedies, make it their own and then proceed to litigate the claim on a State-to-State basis was increasingly regarded as arbitrary and unsatisfactory for the investors. There is no *right* of espousal of claims under international law[96]. Under national law espousal of claims usually remains purely discretionary and the basis, on which one claim is espoused by the government and another is not, is often non-transparent[97]. Since a private claim by espousal is made into a claim of the government, it is also discretionary whether the investor in the end would obtain full compensation, even if the State received it.

Secondly, the domestic legal systems of capital-receiving states were often seen as unfit to protect the interests of foreign investors. In the case of developing countries domestic legal systems were often perceived as weak, lacking the capacity and the independence or authority to assess complicated claims against the State. As to developed countries, judicial systems were regarded as too complicated, consisting of too many layers (local, regional, federal, European) or too many different specialized judicial authorities (administrative, civil, tax and customs jurisdictions) and as requiring legal assistance that is frequently too costly[98].

Thirdly, by removing the requirement of exhaustion of domestic remedies and allowing immediate access to international procedures BITs guarantee faster and more efficient proceedings. Although the average BITs arbitration nowadays also takes three years, this is still considerably faster than the time it takes to exhaust available remedies in most developed national judicial systems[99]. The setting aside of the need for espousal of a private claim and bringing a claim directly to international arbitration outside any national legal system is clearly influenced by the common practice in commercial arbitration.

3.4.1 Consultations

Most BITs prescribe consultations before allowing resort to courts or international arbitration. In order to oblige both parties to participate in such consultations, such provisions usually prescribe a minimum period of often six months during which parties need to negotiate in order to settle their dispute[100]. Parties are often also free to rely on services of good will or conciliation by third parties. Enabling settlement of the dispute before resorting to arbitration is important, as it can avoid lengthy and costly arbitration trajectories. If consultations do not lead to agreement both the capital exporting state and the investors themselves can start legal procedures against the capital receiving state.

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[95] Naboth van den Broek, *op. cit. fn.* 30, at p. 27.

[96] Robert Jennings and Arthur Watts (eds.), *Oppenheim's International Law*, 9th ed. London, Longman 1993, 934

[97] If, as is argued by Annemarieke Vermeer-Künzli, 'Restricting Discretion: Judicial Review of Diplomatic Protection', 75 (2006) *Nordic Journal of International Law* 279, there is an increasing tendency to restrict the discretion of states in offering diplomatic protection in cases of serious breaches of human rights law, this development seems to have had very limited resonance where espousal of economic claims is concerned.

[98] It also bears pointing out that the success rate of private claims in the administrative courts in Western Europe is, according to stastitical evidence somewhere between 10% in France and 30% in Germany.

[99] I am indebted to Steffen Hindelang for the information on the average length of investment arbitrations. I am relying largely on my own experience with a multitude of administrative and civil claims that have risen to the highest national level and gone through a preliminary question to the ECJ in Luxemburg to be able to say that one would have to be very lucky to make it within three years before the ECJ. Slow justice often becomes injustice.

[100] Jeswald W Salacuse, *op. cit. fn.* 3, at p. 362.

3.4.2 International Arbitration

Most BITs contain an extensive set of rules for the international settlement of investment disputes. These articles appoint the bodies that will be called upon to settle the dispute, and indicate the applicable law governing the dispute.

BITs often contain a list of potential tribunals that may be entrusted with the settlement of an investment dispute. Such can be institutions like the International Centre for the Settlement of Investment Disputes, the Permanent Court of Arbitration, the International Chamber of Commerce of Paris, or the London Court of International Arbitration. Another option most BITs mention is ad hoc arbitration, which means that both parties will appoint a number of arbitrators who will form an ad hoc tribunal[101].

International arbitration usually applies the law that the parties declared applicable when entering contractual agreements. For this reason, most BITs provide which laws govern the dispute. Here, considerations of territoriality usually lead to application of the laws of the host state. But parties can also declare a vast array of other sources of law applicable, such as the 'general principles of law applicable in Western Europe' or rules of international law[102]. On the other hand the choice of tribunal sometimes influences the applicable law, as for example the ICC and the Stockholm Arbitration Institute have their own rules concerning applicable law[103]. Clear choice of law is important, as it improves legal certainty. If a lack of clarity about applicable law leads to a conflict of law, the arbitral tribunal has to determine the applicable law[104].

The question of applicable law is of great importance, when the dispute is principally about the alleged breach of an investment contract or of contractual obligations ancillary to other actions under public law by the host State's authorities that affect an investment protected by a BIT. When the acts by the authorities of the host State, whether of a legislative, regulatory, or purely executive nature are at the core of a dispute, there can be no doubt that the applicable law is the BIT itself and general international law, in particular its rules of treaty interpretation, in the background. It can be regretted that BITs mostly do not explicitly declare that they have to be interpreted according to the rules of interpretation of international law. In practice it appears that arbitrators, especially those that have a background in commercial arbitration, are insufficiently aware of this. Hence such an affirmation would be useful.

Here it is necessary to return for a moment to the selection of arbitrators who make up the Arbitration Tribunals that decide investment disputes. The ICSID, the PCA, the ICC of Paris, the LCIA and the Stockholm Arbitration Institute are, as was already briefly indicated in the Introduction, service institutes that help to compose the Arbitration Tribunals and provide registry services and administrative support (against certain fees). They also serve as appointing authorities, but the actual selection of the members of the Arbitral Tribunal is in the hands of the parties or rather of their law firms, which will later on plead the case in front of the Tribunal that they will have helped select themselves. This is a practice that comes from the world of commercial arbitration. The law firms each propose to their client several names of possible candidates, from which the clients choose. That choice is implemented by the law

[101] Naboth van den Broek, *op. cit. fn.* 31, at p. 28.

[102] Rupert Reece, Alexis Massot and Marie-Hélène Bartoli, 'Searching for the Applicable Law in WTO Litigation, Investment and Commercial Arbitration', *in:* Jorge Huerta-Goldman, Antoine Romanetti and Franz Stirnimann (ed.), WTO Arbitration, Investment Arbitration, and Commercial Arbitration, Alphen aan den Rijn, Kluwer Law International 2013, 199, pp. 201-202.

[103] See Art. 21 of the ICC 2012 Rules of Arbitration and Art. 22 of the Arbitration Rules of the Stockholm Arbitration Institute, which are broadly identical.

[104] Rupert Reece, Alexis Massot and Marie-Hélène Bartoli, *op. cit. fn.* 103, at p. 203.

firms and thus the 'arbitrators of the parties' are selected. These two are supposed to agree on their President, a process that is again steered by the law firms under more or less stringent guidance of their clients[105].

As a consequence of this procedure the law firms specializing in international arbitration have great influence on the kind of people who sit on investment tribunals. Naturally they have a tendency to look for people with knowledge of and experience in arbitration, which in practice means mostly male lawyers from similar firms and the odd (again male) professor who is a specialist in international arbitration. Since law firms specializing in international arbitration are mainly present in Western Europe, the US and (to a lesser extent) Latin-America[106], the selection mechanism leads to panels of arbitrators which show not only a lack of gender diversity, but also of diversity in national and cultural background[107]. In addition, because of the selection practices the pool from which members of investment arbitration tribunals have been selected is quite small. This leads to situations in which, for instance, two members of an arbitration tribunal will meet each other as lawyers on opposite sides in another BITs arbitration and vice versa; or one of them will have to plead another case in front of the other quite soon[108]. Especially when such cases have points in common, which is not exceptional given the fairly limited scope of the legal questions that may arise in BITs cases due to the quasi-uniformity among BITs, this can lead to situations which are rather painful and are likely to be regarded at the very least as undesirable, if they do not amount to a full-fledged conflict of interest.

Fortunately some initiatives are being taken to remedy the selection problem. The Secretariat of ICSID, which has a certain informal influence on the choice of persons considered for serving as arbitrators[109], has done its best to enhance gender and cultural diversity by proposing more women and also to be sensitive to national and cultural diversity. This is beginning slowly to have some effect, but it is high time that a stronger and more general effort is made.

Professional societies are attentive to situations of conflict of interest and other incompatibilities. The International Bar Association (IBA) has adopted rules on conflict of interest and ethics in the field of arbitration. These are often referred to when panels of arbitrators are composed or when challenges to the composition of panels are made.[110] In addition two professional societies, the American Society of

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[105] If the arbitrators of the parties cannot agree, there often is a safety mechanism according to which the President of the ICJ, the Secretary-General of ICSID or another authority figure appoints the President of the Arbitration Tribunal, see e.g. Article X-25 of CETA as published by the European Commission, *loc. cit. fn* 38.

[106] It should be noted that Singapore is styling itself more and more as the arbitration capital of Asia and there is no doubt that this is already having an effect.

[107] For instance in all ICSID cases 46% of all arbitrators are from Western Europe and 22% from North America, whereas 1% of the cases has a European defendant State and 5% have a North-American State (including Mexico) as defendant. Women are appointed as arbitrators in 5.6% of the ICSID cases and three quarters of those appointments are taken by two women only. See Chiara Giorgetti, 'Is the Truth in the Eyes of the Beholder? The Perils and Benefits of Empirical Research in International Investment Arbitration', 12 Santa Clara Journal of International Law 2013, 263.

[108] Note in this respect the initiative of the ICJ a few years ago in which it announced that it considered it undesirable that lawyers who served as judges *ad hoc* on the Court, i.e. as judges appointed by a party that is not represented on the Court, while the other party in the dispute has an elected judge on the Court, would be taken from lawyers who regularly appeared before the Court as advocates. International Court of Justice, *Practice Directions,* available at: http://www.icj-cij.org/publications/en/acts-and-documents-no-6.pdf (last accessed 23 May 2013) p. 163, Practice Direction XIII.

[109] This influence is largely brought to bear by suggesting names for arbitrators and possible Presidents of tribunals to the lawyers of the parties in ICSID arbitrations. There has been quite some empirical research on the selection of arbitral panels and dissenting opinions. This literature is critically discussed in Catherine Rogers, 'The Politics of International Investment Arbitrators', 12 Santa Clara Journal of International Law 2013, 223 and in Chiara Giorgetti, *op. cit. fn* 107.

[110] International Bar Association, IBA Guidelines on Conflicts of Interest in International Commercial Arbitration and Rules of Ethics for International Arbitrators available at: http://www.ibanet.org/Publications/publications_IBA_guides_and_free-_materials.aspx (last accessed 23 May 2014). Referred to in Article X.25.6 of CETA as published by the European Commission, loc. cit. fn 36.

International Law (ASIL) and the International Council for Commercial Arbitration (ICCA) have taken the initiative to create an international commission under mixed US-European chairs that is to report on issue conflict in international arbitration, including BITs arbitration[111].

When the WTO Agreement was negotiated, it was considered that WTO panels often would take decisions with serious consequences for individual Members. Hence, the WTO dispute settlement system was equipped with the newly created Appellate Body. It is suggested that decisions of arbitration panels under BITs can have effects at least as important and dramatic as those of WTO panels. It would seem, therefore, that an appellate mechanism is highly desirable also in investment dispute settlement[112]. A big practical problem is that investment dispute settlement is not based on a single international agreement like WTO dispute settlement. Nevertheless, it is urgent that some kind of appeal mechanism should be organised. At present, the only mechanism that exists is the so-called annulment procedure under the ICSID Convention, which is handicapped by the extremely limited grounds for annulment of arbitral awards (unlawful constitution of the panel; manifest *excès de pouvoir*, corruption of a member of the panel; breach of fundamental rule of procedure; failure to state reasons)[113].

3.4.3 Enforcement of Arbitral Awards

There is no doubt that arbitral awards under ISDS procedures are binding between the disputing parties.[114] Under international law this implies that all organs of a State or International Organization, party to a BIT, are bound to observe and carry out the arbitral award. This includes the judicial organs of the State or international organization. In the EU this means that not only the Commission, the Council of Ministers and the European Parliament are bound by an award of an investment tribunal, but also the Court of Justice. The Court itself has admitted as much, when it stated that, in case the EU were to conclude an international agreement which included a dispute settlement mechanism and an international tribunal, it would be bound by the judgments of that tribunal.[115] However, the ECJ's record of wholehearted acceptance of, for instance, the reports of WTO panels and the Appellate Body – a comparable international jurisdiction to investment tribunals – is quite sketchy. The picture is obscured by the consistent rejection of the direct effect of the WTO Agreements, but also the direct application by the ECJ of an international court's sentences is often shrouded in quite some mystery. Going by the experience of the ECJ's handling of WTO panel and Appellate Body cases lost by the EU, one may expect that the ECJ will follow adverse investment tribunal rulings without being explicit about it, often relying on interpretation of Union law in order to enable the Union's other institutions to follow and implement

[111] See ASIL Blog: http://www.asil.org/blogs/icca-asil-joint-task-force-issue-conflicts-investor-state-arbitration. So-called issue conflict means that a person ought to be disqualified to sit on an arbitration panel, not so much because of a conflict of interest (which is fairly well defined in most legal systems), but conflict that may arise because of previous positions held, previous publications, and previous arbitral decisions etc.

[112] An example in investment arbitration is the procedure in Articles 20.13 and 20.14 of the so-called CAFTA Agreement, in: Martins Paparinskis, op. cit. fn 26, 272 ff. This is a procedure very much like the interim review procedure laid down in Article 15 of the DSU of the WTO. That is to say a provisional or interim report of the panel can be commented by the parties, after which the final panel report will be issued, modified or not. It is not a real appeal procedure; in the WTO it precedes the appeal and has proved largely superfluous as a consequence.

[113] See Article 52 (1) of the ICSID Convention, op. cit. fn. 19.

[114] Article 9(5) of the 2008 German Model Treaty and Article 9(5) of the 2008 UK Mode;l Treaty, see also Article 53 of the ICSID Convention, in: Martins Papaprinskis ed., *op. cit. fn 26*, 573, 580 and 693 respectively. See also Article X-39 of the draft chapter on ISDS in CETA, Draft as published by the European Commission, *op. cit. fn 38*.

[115] Opinion 1/91, *EEA Agreement I* [1991] ECR I-6079, para. 39. See also Pieter Jan Kuijper, "It shall contribute to the strict observance and development of international law…." The Role of the Court of Justice, in: "The Court of Justice and the Construction of Europe. Analyses and Perspectives on Sixty Years of Case Law, The Hague, T.M.C. Asser Instituut 2013, 589, at 608-610 and literature and case law cited there.

these rulings, too.[116] A clear limit is reached for the ECJ in case a judgment of an international court that is binding on the Union would be contrary to the constitutional core values of the Union.[117] It is important to note that the above applies to the situation, when the EU concludes a trade and investment agreement with a third State, like the TTIP. The position of the ECJ in cases decided by investment tribunals on the basis of intra-EU BITs between different Member Sates is probably a different one, but not the subject of this contribution.

After obtaining a binding arbitral award, it is of paramount importance that the award is enforced and recognised in the country where it ought to take effect. For example, in case arbitrators have ruled that a foreign investor should receive compensation following indirect nationalisation, it is of greatest importance to the investor to have the award recognised and enforced by the domestic courts of the host state, in order actually to receive the compensation in case the state does not comply voluntarily. This is however not always easy, since a judgement by an arbitral tribunal is often not a directly enforceable judgement like domestic jurisprudence. For this reason, various international instruments govern the recognition and enforcement of arbitral awards. The matter is even more complicated if an investor seeks to have an award by a foreign domestic court recognised and enforced before the courts of the host state. Both situations need to be separated, and are governed by different instruments of law.

The aforementioned *Convention on the Settlement of Investment Disputes between States and Nationals of other States* (the ICSID Convention) provides that arbitral awards made pursuant to the Convention shall be binding on the parties, and that state parties to the Convention must treat such awards as if they were 'a final judgement of a court in that state' and thus pay all damages awarded[118]. Thus, states party to the Convention are bound to enforce ICSID arbitral awards as judgments by national courts.

The most important other instrument concerning the recognition and enforcement of international arbitral awards is the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the 'New York Convention'), which was initially created primarily for the execution of awards resulting from commercial arbitration, but can also be used for the enforcement of other international arbitral awards, such as investment arbitration awards[119]. Currently, there are 149 state parties to the Convention[120]. The Convention provides a presumptive obligation of states to recognize and enforce arbitral awards, provided that certain requirements have been met. Most importantly, the Convention applies only to international awards, that is, awards made outside of the state where enforcement or recognition is sought. Awards from domestic courts of the state where enforcement is sought are usually dealt with under a separate regime of domestic law. However the Convention also applies to non-domestic awards, awards that the State where enforcement is sought does not consider as domestic even though they were made in that state. Thus the Convention allows states to extend its

[116] An example is Case C-351/04 *Ikea Wholesale Ltd v Commissioners of Customs and Excise,* [2007] ECR I-7723, paras 53-57. For a case in which the Court exceptionally refers approvingly to an AB report, see case C-245/02, *Anheuser-Busch v Budejovicki Budvar,* [2004] ECR I-11018, paras 49 and 67.
[117] This follows from the so-called Kadi cases, see Joined Cases C-402/05 P and 415/05 P, *Yassin Abdullah Kadi v Commission and Council,* [2008] ECR I-6351, paras. 307 ff and Joined Cases C-584/10 P, C-593/10 P and C-595/10 P *European Commission and United Kingdom v Yassin Abdullah Kadi.*para. 97 ff.
[118] Convention on the Settlement of Investment Disputes between States and Nationals of other States (signed 18 March 1965, entry into force 14 October 1966), 575 UNTS 159, Articles 53 & 54. For similar provisions in the TFEU concerning the enforcement of the ECJ's judgments in the Member States see articles 280 and 299 TFEU.
[119] UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (signed 10 June 1958, entry into force 7 June 1959), 330 UNTS 3 ('the New York Convention').
[120] A list of all state parties to the New York Convention is available at: http://www.uncitral.org/uncitral/en/-uncitral_texts/arbitration/NYConvention_status.html [last accessed 14 May 2014].

application and treat these non-domestic awards like international awards[121]. An example of this is the US courts' practice to treat awards made within the US as non-domestic if the award bears a 'reasonable relation' to another state, which for example would be the case if the award were made pursuant to the laws of another state[122]. Other requirements are of a formal nature, for example obliging applying claimants to translate the award into the language of the state where enforcement is sought[123].

Once these requirements have been met, the presumptive obligation to recognise and enforce the award can be effectively blocked by a state on several defences. Recognition and enforcement may for example be rejected in case of invalidity of the arbitration agreement, if the rights of the defendant were impaired during the proceedings, in case of procedural shortcomings in the appointment of the arbitrators, if parts of the award were made outside of the jurisdiction of the Tribunal, if the award has not become binding on the parties because of suspension by a competent domestic authority, if domestic law excludes the subject matter of the award from arbitration, or if recognition and enforcement would be contrary to public policy of the state in which the award is invoked. This list is exhaustive; no other grounds for refusal to recognise or enforce an award are permissible[124]. Since the domestic courts of the state in which recognition or enforcement is sought have to decide on the fulfilment of one of the grounds for refusal, state practice on this matter can vary considerably[125].

Since many states have signed and ratified both the New York and ICSID Conventions, these two Conventions, each in their own way, ensure recognition and enforcement in a large number of cases. This has made valuable contributions to foreign investment security.

4. HOW INTERNATIONAL INVESTMENT BECAME INTERLINKED WITH INTERNATIONAL TRADE LAW

4.1 GATT and Trade-related investment measures

Immediately after the Second World War, trade and investment were supposed to be joined in one broad international convention, the founding treaty of the International Trade Organization (ITO). As is well known, the ITO never made it to wide ratification, after President Truman renounced putting it before the US Senate, given the hostile position of this body to the agreement. Article 12 of ITO contained a number of provisions that would at least have laid down a number of minimum rules and aspirational norms on international investment and an encouragement to conclude bilateral investment agreements[126]. When after the ITO's demise only the provisionally applied GATT was left over, the link between trade and investment was torn asunder for quite some time to come.

There remained nevertheless a number of fundamental GATT provisions that are affected by measures that were in the past often taken by governments that applied a license system for foreign investment. As a condition for the investment being approved governments often imposed so-called performance requirements, i.e. requirements which obliged the investor to buy a specific minimum quantity of

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[121] New York Convention, *loc. cit. fn.*120, Articles 1-3.
[122] Gary B. Born, *International Arbitration. Law and Practice,* Alphen aan den Rijn, Kluwer Law International 2012, p 372,
[123] New York Convention, *loc. cit. fn.*120, Article 4.
[124] Alan Radfern, Martin Hunter and others, *Law and Practice of International Commercial Arbitration*, London: Sweet & Maxwell 2004, pp. 440-459; New York Convention, *loc. cit. fn.*119, Article 5.
[125] Herbert Kronke, 'Introduction: The New York Convention Fifty Years on: Overview and Assessment', *in:* Herbert Kronke , Patricia Nacimiento , et al. (eds), *Recognition and Enforcement of Foreign Arbitral Awards. A Global Commentary on the New York Convention*, Alphen aan den Rijn, Kluwer Law International 2010, pp. 1-18, p. 16.
[126] The ITO Final Act, including the ITO Agreement, can be found on the WTO website, http://www.wto.org/english/docs_e/-legal_e/havana_e.pdf (last accessed 22 May 2014).

national products of the host State as inputs for its production, or which subjected the investor to a minimum export performance, in case he wanted to import such inputs instead. Many other requirements of this nature were devised, always making the initial investment itself and the way the business was run dependent on a certain performance that was likely to discriminate in favour of national products or that had a restraining effect on imports or a stimulating effect on exports. In a famous GATT dispute settlement case of 1984, *Canada – Administration of the Foreign Investment Review Act (FIRA)* the panel determined that such practices breached the national treatment clause of Article III:4 of GATT and was potentially also contrary to Article XI, the prohibition of quantitative restrictions[127].

The *FIRA case* was considered so important that its codification became part of the Uruguay Round negotiation mandate and led to the *Agreement on Trade Related Investment Measures* (TRIMs Agreement)[128]. The negotiators, however, could not agree to go beyond what the *FIRA case* had already decided and its immediate logical consequences[129]. Article 2 of TRIMs simply states that no Member shall apply TRIMs that are inconsistent with the Articles III and XI of GATT and then refers to the illustrative list of such TRIMs contained in Annex 1 to the agreement. The practices contained in the illustrative list cover not only the conditions of access to the market of investment in the production of goods, but also the conditions under which continued enjoyment of the gains of the investment remain possible. There is little doubt that this leads to an overlap between the TRIMs Agreement and numerous BITs on the point of national treatment, and possibly on FET. It might also be argued that in this situation the potential value of the investment is truncated from the beginning, because of the conditions imposed, but it would go rather far to characterize this *ab initio* as a partial expropriation without compensation.

The TRIMs Agreement is not an agreement that has attracted an enormous amount of litigation under the WTO Dispute Settlement Understanding. Any litigation that has taken place has remained largely true to the text of the Agreement and its Annex containing the illustrative list and has further extrapolated the fundamental ideas behind the *FIRA case*. Since Article 2 of the TRIMs Agreement simply refers to Articles III and XI of the GATT, cases such as *Indonesia - Autos*[130], *India - Autos*[131] and *China – Auto Parts*[132] have not done much more than apply existing case law to clear cases of discrimination in favour of national products through tax and legislative means under Article III: 2 and 4 and obvious quantitative restrictions under Article XI respectively, with the occasional reference to the examples mentioned in Annex I of TRIMs.

It is remarkable that the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada in its draft Chapter on Investment has included an elaborate list of Performance Requirements, which in reality is a further development of the illustrative list of Annex I of the TRIMs Agreement. At the same time parties seem to want to leave their obligations under the TRIMs Agreements unaffected[133].This can lead to all kinds of complications, especially in dispute settlement in the relation between WTO dispute settlement and CETA dispute settlement and within CETA it will be unclear whether to treat Performance requirements under the trade dispute settlement provisions on the basis

[127] See Panel Report adopted on 7 February 1984, GATT BISD 30S/140, paras 5.4-5.12 (on Art. III:4) and 5.14 (on Art. XI:1).
[128] See the first preambular paragraph to the TRIMs Agreement and its reference to the Declaration of Punta del Este.
[129] Art. 2 TRIMs Agreement and its Annex 1
[130] See Case DS 54, 55, 59 and 64 *Indonesia Autos*
[131] Case DS146 and 175 *India Autos*.
[132] Case DS339, 340, 342 *China Auto Parts*
[133] See Article X:5 of the draft CETA as published by the European Commission, *loc. cit.* fn. 37. This article seems to have been borrowed from Article 1106 of NAFTA.

of the national treatment principle and the prohibition of quantitative restriction or under the investment chapter ISDS or both.

4.2 The GATS and services provided through establishment of 'commercial presence'

The GATT and, therefore, the TRIMs Agreement cover trade in all goods and thus subject all TRIMs on goods trade to the basic rules of national treatment and the prohibition on quantitative restrictions. However, the GATS has a different structure and only has similar effects once Members have made commitments to subject trade in services to the full force of the national treatment principle and thus to open up their market for services in whole or in part to foreign competition[134]. The GATS distinguishes between four so-called modes of providing services and the mode that is relevant for our discussion is the third mode, namely 'the supply of a service .... by a service supplier of one Member, through commercial presence in the territory of any other Member'[135]. This mode of service supply essentially operates by the establishment of a subsidiary or branch in another WTO Member and therefore constitutes an investment within the meaning of most definition clauses of most BITs.

It is obvious that, insofar as Members have made commitments for various service sectors in their schedules of commitments for services, this entails *ipso facto* that the various kinds of quantitative restrictions, which were habitually imposed by most States on many services sectors are no longer acceptable[136]. This shows that the quantitative limitations that were covered by Article XI:1 GATT are also covered by GATS, once commitments are given. In addition the applicability of the national treatment clause of GATS is automatically triggered as well by making a commitment for a certain service sector and thus this aspect of the TRIMs Agreement is also covered by GATS[137].

The difference between GATT and GATS where the regulation of foreign investment is concerned can be explained as follows. Under GATT and TRIMs investment in goods production is disciplined only indirectly, namely insofar as it has an influence on trade in goods. Under GATS investment in services as such is subjected to the most important provisions of that Treaty, but only insofar as Members have liberalized their services trade by making a commitment to observe national treatment. Attempts have been made to characterize GATS rules as pre-establishment rules and all other norms on the treatment of investment as true investment rules and on that basis to decide where to allocate disputes. Nevertheless, it is clear that there is potential overlap between the national treatment clauses of most BITs and the provisions on national treatment of services delivered by the third mode of commercial presence (at least insofar as services commitments have been made by Members).

4.3 TRIPs and intellectual property rights recognised as 'investments'

The TRIPs Agreement provides for a minimum harmonization of intellectual property rights even for those WTO Members which are not parties to (all) major world-wide intellectual property conventions. This level of minimum harmonization is subject to the classical GATT clauses of most-favoured nation and national treatment. Since intellectual property rights in general come under the definitions of 'investment' given in most BITs[138]. It is obvious that, therefore, there are considerable zones of overlap between the TRIPs Agreement and BITs as far as the protection and equal treatment of intellectual

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[134] Such 'commitments' are the equivalent of tariff concessions under the GATT.
[135] Art. 1.1(c) of GATS.
[136] See Article XVI GATS, which lists the kinds of limitations that are no longer allowed after making a commitment
[137] See Article XVII GATS on national treatment
[138] See Article 1 (Definitions) in the Model Investment Agreement of France, the US, the Netherlands, Germany and India and Art. 2 of the Norwegian Model Treaty, see Martins Paparinskis ed., *op. cit. fn.* 26, at p. 45-53. See also Article X:3 CETA draft as published by the European Commission, *loc. cit. fn 38.*

property rights are concerned. The only (model) BIT so far that is dealing (partially) with this problem seems to be the 2012 US Model BIT[139].

5. OVERLAPPING AREAS OF INTERNATIONAL TRADE LAW AND INTERNATIONAL INVESTMENT LAW: POSSIBLE SUBSTANTIVE AND PROCEDURAL CONFLICTS?

The preceding paragraphs have shown that there is considerable overlap between the substantive law of international trade and the substantive law of international investment. It is evident that both fields of law can be seen as two sides of the same coin. Hence there is logic in treating them together in the same broad (trade) treaty and negotiating about these matters together in the process leading up to such treaty.

Both the overlap and the lack of it can generate problems. If there are conflicts between two provisions, one of trade law and the other of investment law, this will raise problems. This is likely to be relatively rare, since in international law, especially WTO law, there is a somewhat lamentable tendency to give a very restrictive interpretation to the notion of conflict between two treaty provisions[140]. But also a lack of overlap may cause problems, for instance if one body of law, namely trade law, contains exceptions (art. XX GATT; Art. XIV GATS; but no corresponding provision on TRIPs) that the other body of law, investment law, does not recognize or believes not to need at all[141]. These exceptions are generally seen as important guarantees safeguarding a reasonable measure of regulatory freedom of the WTO Members. Such overlap (or lack thereof) as between two bodies of substantive law can also generate clashes of jurisdiction between the dispute settlement mechanisms active in the two bodies of international law.

It is obvious that such problems are exacerbated, if the two subject matters are included in the same international agreement and it thus becomes possible to litigate matters in the field of services as an investment matter rather than as a trade matter, where the general exceptions of Article XIV GATS might be successfully invoked. Is that what negotiators intended? Perhaps not, but then it might be better to express that intention very clearly by introducing an exception like Article XIV GATS also in the investment chapter. In the field of TRIPs it is clearly necessary to demarcate which measures by a State will be regarded as TRIPs measures and which ones as investment measures. It may no longer be satisfactory to regard *all* intellectual property rights always as investments, as used to be normal in most BITs.

An easy way out for the arbitration courts handling respectively trade and investment disputes would be to argue that the two procedures are so different, one a State to State procedure and another an investor to State procedure, that it is not necessary to take these differences and contradictions into

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[139] See Article 6.5 which states that certain practices with respect to intellectual property rights, such as *inter alia* compulsory licenses, are not to be considered expropriations, *loc. cit.* fn. 71.

[140] The tendency in the conflict clauses that rule the relation between the GATT and the Agreements on Trade in Goods and that between the WTO Agreement and many Agreements annexed to it is to define a conflict as the situation in which one obligation and another obligation from another agreement clash with each other and then only 'to the extent of the conflict.' It is, however, equally justified to regard a clash between a right and an obligation as a true conflict, even though one of the parties can forego his right, in order to accommodate the obligation of the other party. It would be to underestimate the importance of rights, if they were condemned to have to give way consistently to obligations.

[141] Indeed most BITS do not contain exception clauses comparable to Articles XX GATT and XIV GATS. For example, the Italian Model BIT contains no exception clauses. See Federico Ortino, 'Italy', *in:* Chester Brown (ed.), Commentaries on Selected Model Investment Treaties, Oxford: Oxford University Press 2013, 321. On the contrary, Article 4(2) of the Dutch Model BIT does contain a limited version of an exception clause. See Paparinskis, *op. cit. fn.* 26, at p. 522.

account. This could also be the attitude of the negotiators. This approach would pay insufficient attention to the fact that the investor to State procedure in the final analysis also rests on a State to State agreement and that the consequences can be largely comparable, namely that the State finds its regulatory autonomy considerably restricted.

In CETA, the parties have sought to prevent problems surrounding a possible uneven impact of exception clauses by creating a unified exceptions chapter (largely based on the wording of Article XX GATT) covering the whole agreement[142]. This is an example well worth considering in the framework of TTIP negotiations.

Finally it is important to point out that the remedies in the two procedures are very different. In the WTO and in most bilateral trade agreements, the emphasis is on compliance and there are compensation and trade retaliation as provisional remedies. The real objective is that parties carry out their obligations by complying with the ruling of the arbitrators, since only that ensures that obstacles to trade stay at the agreed level and that is the level at which welfare and competitive consequences of the agreement reach their maximum agreed effect. The logic of the remedies of investment agreements or investment chapters in a trade agreement is totally different. There it is assumed that irreparable damage has already been done to an investor and he must be fully compensated: thus the emphasis is not on compliance (*restitutio in integrum)* but on damages. It is not excluded that compliance and *restitutio in integrum* should also become the first line remedy in investment disputes. This may have the advantage that the investor could return to his investment. For property claims, at least, such return to the *status quo ante*, has been introduced in CETA[143].

6. FOREIGN DIRECT INVESTMENT AS PART OF EXCLUSIVE EU COMPETENCES

The section on how international investment law and the law of international trade became interlinked also explains the logic behind making foreign direct investment part of the trade policy power of the EU. Since TRIMs were part of the trade in goods agreements of the Uruguay Round, this segment of foreign direct investment was part of the exclusive commercial policy powers of the Union in the view of the ECJ as from the beginning of the WTO[144]. After the Treaty of Nice, it was clear that foreign direct investment in services was also part of the exclusive commercial policy powers of the Union. Hence there were only rather limited aspects of foreign direct investment, both in goods production and in services (in particular transport services) still outside the Union's exclusive power in the trade domain, when the negotiations for a Constitution for Europe started. It was on this basis that the Constitutional Convention decided that it was rational to make all of foreign direct investment a subject of the common commercial policy[145]. The Inter-Governmental Conference did not change that in the end, although there was resistance from some Member States, and it was not changed in the Lisbon Treaty either[146].

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[142] See CETA Investment text as published by the European Commission, *loc. cit.* fn 38, p. 20.
[143] Article X.36 (b) CETA Draft, as published by the European Commission, *op. cit. fn*. 38.
[144] See Opinion 1/94 (WTO Agreements), 1994 ECR I-5267, paras 84-86.
[145] Jan Ceyssens, 'Towards a Common Foreign Investment Policy? – Foreign Investment in the European Constitution', 2005 (3) 32 Legal Issues of Economic Integration 259, pp. 269 ff.
[146] See the proposed Treaty Establishing a Constitution for Europe Article III-217 and the Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Community (Lisbon Treaty) Article 158, consolidated into Article 207 TFEU.

The main controversial point, when the discussions about the implementation of the new Article 207 started, was whether portfolio investment could be seen as an integral part of the term foreign direct investment[147]. There are indeed good arguments to say that portfolio investment is normally not included in foreign direct investment and is therefore not covered by the exclusive trade policy powers of Article 207; especially the word 'direct' is an arguable obstacle to that. There is no doubt on the other hand that portfolio investment is covered by the free movement of capital with third countries and thus by the regulatory powers under Article 64 TFEU. Then again the Member States in the Council could refuse to use these non-exclusive powers and demand that EU BITs and trade agreements containing investment chapters should be concluded as mixed agreements. That would go straight against their intention as *'Herren der Verträge'* to create a single comprehensive trade policy article that would cover all the aspects, including investment, of this policy. The considerable number of cases on the delimitation between EU powers and remaining Member State powers in the field of external action, and the common commercial policy powers in particular, which is presently pending before the Court of Justice, seems to indicate that Member States in the present political climate are attempting to roll back part of the *acquis communautaire* and to delay or halt the full implementation of the Lisbon Treaty in this field. Thus far the Court has proved to be resistant to these attempts precisely in respect of the common commercial policy and has handed the Council and the Member States three resounding defeats.[148] It is likely that the Court will also have to decide on the scope of the notion of "foreign direct investment" sooner rather than later.

7. CONCLUSION

Modern Bilateral Investment Treaties are the result of a mix of elements on the one hand from the nineteenth and early twentieth century tug of war about how aliens and their property and investments should be treated by their host countries and protected by their countries of nationality and on the other hand from commercial arbitration. The first movement resulted in establishing the notion of an international minimum standard that, even though it always remained contested, acquired clear dominance, especially in treaty practice after the Second World War. Such treaty practice initially held on to State –State dispute settlement in case of a conflict between the parties. The second movement injected elements of avoidance of national judicial systems, direct participation of affected individuals and companies, and new elements of execution into the mix. As a third element in the mix there emerged a number of dispute settlement treaties or centres, such as the treaty-based UNCITRAL rules and the treaty based ICSID, but also the more informally constituted ICC of Paris, the LCIA of London and the Stockholm Institute of Arbitration, which could be used for the settlement of investment disputes.

This led to the type of modern BIT that has become dominant, with progressively refined provisions, first between developed and developing countries and later also between countries at the same or nearly the same level of development. Their objectives varied with the parties, initially strongly

[147] The discussion in the literature on the questions on the interpretation of the term foreign direct investment in Article 207 was sometimes highly partisan and also driven by the interests of private law firms that were traditionally involved in international investment litigation. Fairly balanced accounts have been produced by Dimopoulos and Bungenberg. See Angelos Dimopoulos, 'The Validity and Applicability of International Investment Agreements Between EU Member States under EU and International Law', 48 (2011) Common Market Law Review, 63, and Marc Bungenberg. The Division of Competences between the EU and its Member States in the Area of Investment Politics', in Marc Bungenberg , Joern Griebel and Steffen Hindelang (eds.), *International Investment Law and EU Law*, Heidelberg, New York, Springer 2011, 29 - 42..

[148] See Cases C-414/11 *Daiichi-Sankyo and Sanofi-Aventis* (scope of 'trade-related intellectual property rights' under Article 207 TFEU) C-137/12 *Commission v Council* (scope of 'services' under Article 207 TFEU) and C-114/12 *Commission v Council* (Article 3(2) TFEU and exclusive external competence of the EU).

development oriented, aiming at the stimulation of the export of capital to developing countries, later more matter of fact, avowing explicitly the mutual protection of investments as an objective and, in some recent instances, showing concern for the State's right to regulate.

Modern BITs fall into two parts: substantive provisions and dispute settlement provisions. The substantive part of modern BITs contain a large number of identical or near identical provisions: definitions, National Treatment, MFN treatment, Fair and Equitable Treatment and Full Protection and Security, a so-called Umbrella clause, free transfer of capital and free transfer of funds, criteria for nationalization or expropriation, the consequences of war, national emergencies and civil unrest, and finally on the criteria for the level of compensation. In the paper all these provisions have been briefly explained and analysed. The dispute settlement clauses of modern BITs are mostly characterized by a direct right of the aggrieved investor to go for international arbitration. In some instances (mostly older BITs) the exhaustion of local remedies is still maintained, although in many instances it is linked to a maximum period, after which the right to international arbitration becomes available to the investor. Some of these provisions have become controversial over time and appear to be in need of improvement. Such improvement is already apparent in the most recent BITs and Model BITs, including the draft investment chapter of the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada.

After this largely descriptive part the paper analyses how international investment protection became interlinked with international trade law, in the end to such an extent that foreign direct investment became part of the common commercial policy powers, which fall under the exclusive competences of the EU. It turns out that investment was already part and parcel of the failed post-war International Trade Organization treaty. Moreover, certain investment measures had strong trade consequences that were already recognized and condemned by the GATT dispute settlement mechanism. These practices were codified as forbidden in the TRIMs Agreement that was part of the WTO package.

Investment protection clauses now turn up more and more in comprehensive bilateral trade agreements. This creates overlap between trade provisions and investment provisions of the same agreement and potential clashes of jurisdiction and, as such may cause a number of problems that need to be carefully taken account of, when drafting such agreements. This also applies to TTIP. The co-existence of trade provisions and investment protection clauses in the same treaty has to be carefully managed, as there can be considerable overlap between the latter and provisions laying down performance requirements which can be seen as trade measures forbidden under national treatment, as well as provisions relating to liberalization of trade in services through the establishment of subsidiaries or branches or trade-related intellectual property measures. In addition different exceptions relating to trade and to investment provisions of the treaty (and even the absence of the latter) may cause painful surprises. This is of particular importance in dispute settlement, for which there must be normally two different procedures, one for trade and one for investment, plus in the background the WTO dispute settlement procedure. All this requires very careful technical legal work in order to avoid needless conflicts or unexpected and unwanted outcomes. A lot of work on this has been done already in the framework of the negotiations on CETA between Canada and the EU and it would be indicated to take over some of the results of that work and perfect it further, where necessary.

Are all these technical complications worth the trouble in order to have an EU-US treaty that covers both trade and foreign investment? Can't we leave out the investment protection part? Is that really necessary between two entities that have been making huge investments in each other's territory without great complications for a long time? Are there really such serious problems in the judicial systems on both sides of the Atlantic that a dispute settlement provision with direct access to international arbitration for investors is necessary?

If one looks at the actual investment disputes brought so far, one is struck by the fact that many procedures have been brought by mid-size investors and even individuals. It would seem that they derive a certain assurance from the existence of these treaties and derive a remedy from it, if necessary. All lawyers who have worked within governments or have started procedures against them know that even the best-organized and seemingly humane governments are capable of acting surprisingly often with great callousness and wantonness against private interests that are somehow seen as not belonging to the normal constituency of that government. And if an element of 'strangeness' is put in the mix, even judicial authorities of countries with highly developed judicial systems turn out to be capable of producing a miscarriage of justice. The EU may have its Bulgaria and Romania, where the judicial system is still under special scrutiny under certain post-accession procedures, the US has its Mississippi, where a Canadian investor was hounded out of the state under pressure of a jury trial that defies description[149]. In short, it is likely that all States have their Bulgaria, Romania, or Mississippi.

The questions about the need of an investment protection treaty between two entities like the EU and the US are certainly legitimate, but it is also too easy to dismiss that need in a facile flush of self-satisfaction about the functioning of our judicial systems on both sides of the Atlantic.

[149] See Loewen v US, ICSID case ARB98/03.

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