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The Treaty Shopping Practice: Corporate Structuring and Restructuring to Gain Access to Investment Treaties and Arbitration

Julien Chaisse *

I. INTRODUCTION

Foreign investment has become increasingly important in shaping the international economic landscape, and this explains the growing significance of the international law and policy of foreign investment in the world.¹ There is a huge number of investment agreements, including both (bilateral) investment treaties (“BITs”) and free trade agreements (“FTAs”) that have investment chapters.²

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¹ See Zachary Elkins, Andrew T. Guzman & Beth A. Simmons, Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2009, 60 INT’L ORG. 811, 843 (2006) (concluding, tentatively, that countries with histories of poor governance may be driven to sign BITs by the need to compete for FDI with countries capable of providing more credible domestic investment protection). In this respect, the tribunal in AIG v. Kazakhstan found that treaties (whether bilateral or multilateral) are an acknowledged source of international law and are often referred to as “law-making treaties” and the BIT itself establishes a rule of law as between the parties thereto. AIG Capital Partners, Inc. v. Republic of Kazakhstan, ICSID Case No. ARB/01/6, Award, ¶¶ 10.1.210.1.3 (Oct. 7, 2003).

² See Mary E. Footer, BITs and Pieces: Social and Environmental Protection in the Regulation of Foreign Investment, 18 MICH. ST. J. INT’L L. 33, 36-39 (2009) (describing how investment treaties have developed towards promoting and protecting foreign investment); M.
Although these international investment agreements ("IIAs") are concluded between States as part of public international law, they are designed to provide rights to foreign investors who are, in an overwhelming majority, foreign private investors. In particular, these investment agreements grant a right to foreign private investors.

Sornarajah, The International Law on Foreign Investment 207 (2d ed. 2004) (stating that one feature of the IIAs is that they are made between unequally powerful parties, which demonstrates this dichotomy in the context of ICSID and IIAs since it relates to the relationship between strong, capital-exporter states that may use power diplomacy to force weaker, capital-importer states to settle in unequal terms) (citation omitted). See also ICSID Database of Bilateral Investment Treaties, available at https://isid.worldbank.org/apps/icsidweb/resources/Pages/Bilateral-Investment-Treaties-Database.bak.aspx (last visited Feb. 21, 2015) (presenting an organized database of BITs listed by country).

3. I use the terms "BITs" and "bilateral investment agreements" in reference to international instruments specifically devoted to the promotion and protection of foreign investment—such as "Bilateral Investment Treaties," "Foreign Investment Promotion Agreements," and "Investment Promotion and Protection Agreements." I refer as "free trade agreements" ("FTAs") all bilateral, regional, or plurilateral arrangements that seek the preferential liberalization of investment flows, along with trade in goods and in services, and often provide rules on other areas, such as intellectual property, competition, and movement of natural persons. Both BITs and FTAs with investment disciplines are encompassed under the broader terms of "international investment agreements" ("IIAs").

4. Andreas F. Lowenfield, International Economic Law 536-37 (2d ed. 2008) ("By the early 1960s, following the wave of decolonization in Africa and parts of Asia, and a wave of take-overs of foreign investments throughout the Third World, it had become apparent that it would be very difficult to achieve consensus on the obligations of host countries toward alien investments (read multinational corporations). The leading international aid institution, the World Bank, began to consider how, on the one hand, it could avoid becoming embroiled in controversies between home and host states concerning expropriation, and on the other hand, how it could assist the resolution of such controversies."). See also Jeswald W. Salacuse, The Emerging Global Regime for Investment, 51 Harv. Int'l L.J. 427, 436–37 (2010) ("[T]he existing international law at the end of World War II—what one might call the 'ancien régime'—failed to adequately protect the foreign investments of their [capital-exporting] nationals from injurious actions by host country government . . . . The need for such protection was heightened by the prospect of post-War economic expansion and the decolonization of territories that had previously been under the control of capital-exporting states.").

5. In this respect, the tribunal in Lemire v. Ukraine Award found that foreign investors covered by a BIT enjoy an additional level of protection: they can avail themselves of the same instruments open to local investors, and additionally they can draw protection from the international law rights conferred by the treaty; the different treatment between foreign and domestic investors is a natural consequence of a BIT; however, this unequal treatment is not without justification; justice is not to grant everyone the same, but sum cuique tribuere and foreigners, who lack political rights, are more exposed than domestic investors to arbitrary actions of the host State and may thus, as a matter of legitimate policy, be granted a wider scope of protection. Joseph C. Lemire v. Ukraine, ICSID Case No. ARB/06/18, Award, 28, ¶ 57 (Mar. 5, 2011).
to file a claim against host states before international arbitration tribunals.  

In recent years, the development of the international law of foreign investment has been criticized for giving too much power to foreign investors, while many have criticized international arbitration for not being able to develop a jurisprudence constante. Despite these critiques, the current regime seems to work well and provide adequate protection to most foreign investors. In this respect, a new practice is emerging with "treaty shopping," which is a new test for the current regime and the ongoing negotiations in the context of the Transatlantic Trade and Investment Partnership ("TTIP") or the trans-Pacific partnership ("TPP").


8. See Charles N. Brower & Stephan W. Schill, Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?, 9 CHI. J. INT’L L. 471 (2009) (positing that, although inconsistency is currently a problem, the passage of time will lead to more uniform results); Susan D. Franck, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 FORDHAM L. REV. 1521 (2005) (proposing the creation of a permanent appellate body, enhanced transparency, and increased academic scrutiny in order to combat inconsistency); Jacques Werner, Making Investment Arbitration More Certain: A Modest Proposal, 44 J. WORLD INVESTMENT 767 (2003) (endorsing an appellate level of review for investment arbitration decisions and arguing that arbitrators should play an active role in consolidating proceedings or staying decisions where other arbitral panels have already issued an award). See also Martins Paparinskis, Investment Treaty Arbitration and the (New) Law of State Responsibility, 24 EUR. J. INT’L L. 617, 626 (2013) (arguing that the choice between direct rights and agency approaches is a matter of treaty interpretation).

There is no official definition of treaty shopping. Also, as a matter of law, treaty shopping is not, in principle, prohibited under international investment law, as the precise purpose of IIAs is to encourage investment. In light of the corporate practice, one can formulate a definition describing treaty shopping as the process of routing an investment so as to gain access to an IIA where one did not previously exist or to gain access to more favorable IIA protection. In addition, treaty shopping can further be narrowed by introducing a temporal element and by focusing the definition on restructuring by the transfer of shares or otherwise at the time when the investment is already under some threat, such as in the case of revocation of a license or termination of a contract. In essence, treaty shopping refers to the practice of structuring (and restructuring) investments to gain access to international jurisdiction.19

I do not argue that the relevance of corporate nationality has disappeared; as a matter of fact, a number of international awards discuss this legal requirement.11 Certainly, it has become so easy for foreign investors to relocate to different jurisdictions that the contents of nationality have largely lost their essence. This article analyzes the magnitude of the treaty shopping practice and draws relevant theoretical and policy implications for proper rule-making. This fills the gap in the literature, as it is based on a comprehensive survey of tribunal awards to assess the real prevalence of treaty shopping. Also, observing that in all systems of law, whether domestic or international, there are concepts framed in order to avoid


11. See, e.g., Hussein Nuaman Soufraki v. U.A.E., ICSID Case No. ARB/02/7, Award, ¶¶ 45–46 (July 7, 2004), IIC 131 (2004) (finding that the claimant was not an Italian national at the relevant times and therefore not covered by the treaty); Champion Trading Co. v. Egypt, ICSID Case No. ARB/02/9, Decision on Jurisdiction, ¶ 288 (Oct. 21, 2003), IIC 56 (2003) (finding that individual claimants were dual United States and Egyptian nationals and therefore could not bring claims against Egypt under the treaty); but see, e.g., Waguih Elie George Siag v. Arab Republic of Egypt, ICSID Case No. ARB/05/15, Decision on Jurisdiction, ¶¶ 200–01 (Apr. 11, 2007), IIC 288 (finding that the claimants had Italian nationality at the relevant times); Ioan Miculă v. Rom., ICSID Case No. ARB/05/20, Decision on Jurisdiction and Admissibility, ¶¶ 104–06 (Sept. 24, 2008), IIC 339 (finding that the individual claimants had acquired Swedish nationality).
misuse of the law; reference may be made in this respect to “good faith” ("bonne foi"), “détournement de pouvoir" (misuse of power) or “abus de droit" (abuse of right). This Article seeks to identify the legal principles used by international tribunals to address the issue of treaty shopping. On this basis, this article more specifically discusses three critical issues. First, whether treaty shopping is good or bad from various angles (from both the state and investor perspectives). Second, what is the implication of having a different type of investment treaty (non-harmonized investment treaties), given that the treaty shopping problem exists? Third, how to mitigate the negative aspects of the treaty shopping problem? What type of provisions and clauses are necessary to prevent treaty shopping or to reduce the negative side of treaty shopping?

The article presents in Part II the recent evolution of international investment law and identifies the legal determinants of treaty shopping. Part III goes on to review the practice and reality of treaty shopping. Subsequently, Part IV provides a mapping of the cause of treaty shopping. Part V then presents an account of existing provisions designed to control treaty shopping. Finally, policy conclusions are drawn in the conclusion.

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12. On these principles, see the wonderful discussion in Venezuela Holdings B.V. v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/27, ¶¶ 169-85, Decision on Jurisdiction (June 10, 2010).

13. Professor Leon E. Trakman writes that the “investor treaty-shopping for intermediary states is not risk free. In particular, an ISA claim brought through an intermediary state, as a forum of convenience, may fail on the jurisdictional ground that the claimant’s legal connection to the intermediary state is insufficiently substantial to lodge a claim from that state. That risk is conceivably accentuated as more states strive for intermediary status, seeking to provide investors with ever readier means of establishing legal connections to investor targeted states. Coupled with these developments is the likelihood of regulators, including ISA tribunals, establishing rules to regulate investor treaty-shopping, which intermediary states will undoubtedly follow by promulgating countervailing measures designed to circumvent those regulations.” Leon E. Trakman, Investment Dispute Resolution under the Transpacific Partnership Agreement: Prelude to a Slippery Slope?, 5 GEO. MASON J. INT’L COM. L. 1, 29 (2013).
II. IDENTIFYING THE SEEDS OF TREATY SHOPPING:
EXPANSION OF IIAS

Corporate structuring and restructuring to gain access to investment treaties and arbitration is a new phenomenon because IIAs are a type of legal instrument. Until recently, foreign direct investments ("FDIs") were perceived to be exclusively governed by national rules and principles. It was only in the early 1980s that a great change in attitude vis-à-vis foreign investment was shown in almost all countries. The international legal framework for foreign investment includes rules of general international law, bilateral, regional, and multilateral agreements, as well as texts without


15. At the regional level, the liberalization movements find themselves in instruments reflecting economic integration efforts, with varying degrees of intensity and success. In this area, a significant case is that the amendments made in 1991 to instruments related to FDI and technology transfer from the Andean Pact countries, which replaced the previous more restrictive regulations. In the same vein, we must mention the provisions in the agreements made after 1989 between the European Community and the countries of Central Europe, as well as those of the successive Lomé Conventions between the European Community and a broad group of countries in Africa, the Caribbean and the Pacific. Beyond the regional integration efforts, similar processes have been started. Investment Principles 1994 for Economic Cooperation in the Asia-Pacific countries ("APEC") and the Charter of the Pacific basin on international investments also reflect, in an explicit way, the dominant trends. See History; APEC, http://www.apec.org/About-Us/About-APEC/History.aspx (for a history of the APEC). In October 1998, members of the Association of Southeast Asian Nations ("ASEAN") signed the Agreement for investments in the ASEAN region, in order to create a more liberal and transparent investment environment area. In other regions, efforts continued in the same directions. See GILBERT R. WINHAM, THE EVOLUTION OF INTERNATIONAL TRADE AGREEMENTS 52-56 (1992); ASEAN Member States. ASEAN, http://www.apec.org/ asean/asean-member-states (last visited Dec. 21, 2014) (ASEAN includes many of the TTP participants).

16. At the multilateral level, the Guide to the Treatment of Foreign Direct Investment 1992, prepared as part of the World Bank, appears to be of particular importance. Theoretically, the normative scope of this instrument is limited, but, according to some authors, it is a substitute for the large multilateral convention whose development has not yet been reached. Other multilateral instruments expressing new trends were discussed, the most important of which are the agreements negotiated in the Uruguay Round, 1994, although
binding force. Currently, the core legal basis for investment mainly consists of treaties between states on this matter.\textsuperscript{17} The role of international rules for foreign investment has expanded considerably, and they remain under constant pressure to expand even more.\textsuperscript{18} So, there are three levels of international investment regulations; these are national (domestic) regulation, IIAs (such as BITs and chapters on investment in preferred trade agreements ("PTAs")), and multilateral rules applicable to the subject of investment. Generally, national regulation seeks to capture the benefits and address some of the potential costs of FDI, whereas international rules are generally designed to provide protection to investors with a view to ensure that they are not subject to unfair and unpredictable treatment by host states, and, in some cases, to provide access to host country markets. In recent years, the considerable expansion of IIAs has strengthened their decisive role in national investment policies. As a result, corporations are looking for these legal guaranties, and treaty shopping can proliferate. Section A explains the significance of investment treaties. Section B discusses the scope of application of these treaties.

sometimes they do not mention those parts which involve or affect investment. These are the General Agreement on Trade in Services ("GATS"), the Agreement on Trade Related Aspects of Intellectual Property Rights ("TRIPS"), and the Agreement on Trade Related Investment Measures ("TRIMS"). These trends were reflected in texts characterless mandatory. See General Agreement on Trade in Services, Apr. 15, 1994, 1869 U.N.T.S. 183. For a commentary, see Laurel S. Terry, From GATS to APEC: The Impact of Trade Agreements on Legal Services, 43 AKRON L. REV. 875, 961, 971, 981 (2010).

17. See Jeswald W. Salacuse, The Treatification of International Investment Law, 13 L. & Bus. Rev. Am. 155 (2007). This “treatification” shows the significant recalibration of international investment law over the last years. See also United Nations Conference on Trade and Development ("UNCTAD"), New York, U.S. and Geneva, Switz., 2014, World Investment Report 2014, annex tbl. III.1 (2012) (listing IIAs as of mid-June 2014) (IIAs have been expanding considerably over the last decade, amounting by the beginning of 2013 to more than 2,800 BITs, whereas fewer than four hundred BITs existed at the end of the 1990s).

A. SIGNIFICANCE OF INVESTMENT TREATIES IN THE MULTI-LAYERED REGULATION OF FOREIGN INVESTMENT

Host countries develop the first level of international investment regulation by promulgating national (domestic) rules in order to ensure that the potential benefits of FDI are realized and the potential costs are avoided. To attract FDI, host states generally combine openness with incentives for investors. This may be because many countries in the world are competing to seek the same investment.19

All these incentives are directed to achieve a common goal of making a host state attractive for investors to invest.20 Although investment has benefits, there may also be disadvantages attached to it, leading to a variety of concerns for the host country. In their national regulation, host states try to respond to such concerns.21

In addition, FDI could have negative spillover effects such as environmental degradation, violation of labor and human rights, limited technology transfer on the pretext of lack of absorption capacity, displacement of labor from domestic industries leading to employment loss, anticompetitive acts, like abuse of dominant position by foreign investors, and transfer pricing that unfairly reduces the taxes paid to the host country.22

19. These incentives are comparable to Free Zones, in which duty-free imports and exports are permitted, together with direct subsidies and other financial incentives, and foreign investment guarantees (e.g., promises to stabilize domestic laws, provide tax relief, and allow currency conversion, and the repatriation of sale proceeds and profits). In the 1980s, the SEZs were created in Shenzhen, Zhuhai and Shantou in Guangdong Province and Xiamen Municipality in Fujian “to attract foreign investment from Hong Kong, Macao and overseas Chinese, to introduce advanced technology from abroad, to generate foreign exchange to aid China’s overall foreign exchange position, to pioneer in China’s economic reform, and lastly, to show the determination of the Chinese government in transforming its economic and social structures.” CHENG YUAN, EAST-WEST TRADE: CHANGING PATTERNS IN CHINESE FOREIGN TRADE LAW AND INSTITUTIONS 78 (1991).


21. These concerns could be summarized as concerns about the effect of FDI on national security and defense, sovereignty, and the balance of payments, including potentially large future remittances by investors, a possibly high import content of FDI projects, protection of domestic industry, control over national resources and noneconomic issues such as the protection of local culture. See, e.g., Benjamin J. Cohen, Sovereign Wealth Funds and National Security: The Great Tradeoff, 85 INT’L AFF. 713 (2009).

22. See Jeswald W. Salacuse & Nicholas P. Sullivan, Do BITs Really Work? An Evaluation
In order to pursue the goal of attracting FDI and simultaneously addressing these fears, a variety of approaches can be found in national regimes dealing with foreign investment. International investment law provides rules to ensure access for foreign investment to host country markets and to protect investment against risk (especially political risk). It creates a specific set of investment protection obligations on host countries, including protection against expropriation without compensation and also gives access to financial compensation through investor-state arbitration where the host country breaches a protection obligation. Unfortunately, at present, we do not have any comprehensive multilateral agreement on investment either under the ambit of the World Trade Organization ("WTO") or anywhere else. Hence, international rules on investment are fragmented and there is a wide variety of obligations. The WTO Agreement on Trade-Related Investment Measures ("TRIMS") does refer to investment, but it is a very limited agreement, dealing only with investment rules that have an impact on trade in goods that is contrary to the General Agreement on Tariffs and Trade ("GATT"). The WTO General Agreement on Trade in

23. See William W. Burke-White & Andreas von Staden, Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties, 48 Va. J. Int’l L. 307, 349 (2008). For example, policy instruments may limit foreign ownership in specific sectors, subject foreign investments to mandatory approval requirements, or introduce performance requirements like permitting foreign investors to invest only if (i) they enter into a joint venture with a local firm to invest, (ii) they buy their inputs locally in the host country (local sourcing requirements), (iii) they limit their imports to the value of their exports (trade balancing), (iv) they meet export performance requirements, (v) they produce certain products (product mandating), or (vi) they engage in technology transfer. Other measures include restrictions on land ownership, the repatriation of investment, or the conversion of currency. The host country, while introducing these policy instruments, needs to be aware of the fact that at the end of the day the market needs to still look attractive if it is going to attract FDI.

24. Under the WTO’s Doha Development Agenda, the possibility of negotiations on investment was originally included in 2001 but it was dropped in 2004. There was a prior attempt to negotiate a Multilateral Investment Agreement ("MIA") between OECD countries as a plurilateral agreement, but these negotiations ended without success in 1997. See Riyaz Dattu, A Journey from Havana to Paris: The Fifty-Year Quest for the Elusive Multilateral Agreement on Investment, 24 Fordham Int’l L.J. 275 (2000) (discussing the failed MIA negotiations).

25. Customary International Law is applicable to investment but its content is limited and disputed.

26. TRIMS mainly prohibits performance requirements which are contrary to national
Services ("GATS") agreement, under Mode-3 Commitments on commercial presence, applies to some kinds of investment in services.\textsuperscript{27}

The main source of international investment law is other treaties, sometimes called IIAs, which include preferential trade and investment agreements ("PTIAs").\textsuperscript{28} These address investment and BITs.\textsuperscript{29} They provide more comprehensive rules on investment. IIAs also include double taxation agreements ("DTAs").\textsuperscript{30} Many IIAs

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27. This includes services supplied by a service supplier of one State, through commercial presence in the territory of the other State. \textit{Cf.} General Agreement on Trade in Services, Apr. 15, 1994, 1889 U.N.T.S. 183.


(other than DTAs) provide for investor-state dispute ("ISD") settlement.\textsuperscript{31} About two-thirds of cases are handled under the International Convention on the Settlement of Investment Disputes ("ICSID").\textsuperscript{32} This convention does not create any substantive obligation on party states, but offers only a dispute resolution process for ISD settlement.\textsuperscript{33}

Bilateral treaties are symmetric in the sense that they establish identical rights and obligations for both parties.\textsuperscript{34} The conclusion of these treaties binding unilateral commitments of states represents the internationalization of these commitments. This is because an international agreement is considered to deliver better standards and more reliable protection than national law alone, which can be modified unilaterally.\textsuperscript{35} The agreement, to this effect, traces the legal framework of general application to publicly and solemnly define a


\textsuperscript{34} See Alexandra N. Diehl, \textit{Tracing a Success Story, or “The Baby Boom of BITs”: Characteristics and Particularities of the Tight Net of Bilateral Investment Treaties Existing Today}, in \textit{INTERNATIONAL INVESTMENT LAW IN CONTEXT} 7, 11 (August Reinisch et al. eds., 2008).

balanced set of rights and duties for each of the contracting parties. This general framework is reduced in all cases to the famous triptych: treatment, protection, and investment guarantee.

The “purpose of investment treaties is closely tied . . . to the removal of obstacles that may stand in the way of allowing and channeling more foreign investment into the host states.”36 Thus, from a policy point of view, “the host state deliberately renounces an element of its sovereignty in return for a certain new opportunity: the chance to better attract new foreign investments, which it would not have acquired in the absence of a treaty.”37 Professor Andrew Kerner argues that BITs address the credibility problem in two ways: firstly, ex-ante costs (signals), and, secondly, ex-post costs (commitments). The interplay between these two is important: “In a setting of imperfect information, all commitments are signals but not all signals are commitments.”38 Signaling, in the case of IIAs and FDI, may be defined as “sending a broadly received “signal” that a country is trustworthy.”39 There are many types of signals possible, and hence signals comprise a wide range of policy actions of the host country government. In other words, doubts about the true intentions of the host country government—based on the above-described information asymmetry—can be reduced on the part of the investors, as they “update” their beliefs when the host country signs or ratifies a BIT. Hands-tying of ratifying host states is manifested when IIAs “present significant ex-post costs to signatory states that violate the agreement.”40 In this view, a BIT is a commitment device.41

36. RUDOLF DOLZER & CHRISTOPH SCHREUER, supra note 18, at 23.
37. Id. at 23.
40. Id. at 73–102.
41. How do commitments raise ex-post costs? According to Tim Büthe and Helen Milner, formal agreements, such as treaties, make them more visible. For example, most BITs can easily be downloaded from the web. In addition, organizations like UNCTAD publish reports on investment policies of (some of) their member states. Also, multinational enterprises that benefit from BITs have an incentive to make violations of BITs public. Reasons like the aforementioned thus make commitments more credible and hence should lead to more FDI. Yet, by far the most important reason why BITs make commitments more credible is that there is a mechanism that makes it easier “to bring costly pressure on governments if they do not
Since a BIT includes a number of commitments between two sovereign governments, violating a BIT (i.e., deviating from announced policy) “constitutes a breach of international commitments, which should make those commitments more costly to break.” In summary, commitments enshrined in IIAs have the potential to overcome the problems of time-inconsistency and adverse selection simultaneously. An efficient agreement between the host state and the investor can be reached, because the hand-tying and the signaling mechanism lead to the fact that commitments by the host state are seen as (more) credible by the investor.

As Professors Srividya Jandhyala and Robert Weiner summarize, “BITs provide greater certainty about the future treatment of assets by the state . . . which allow[s] firms to appropriate higher returns from their foreign assets.” Thus, (more) efficient location choices can be made, and hence conceptually BITs should have a positive effect on FDI. There are certain limitations to this view, and they are discussed in the concluding section. In addition to the theoretical reasoning above, Jandhyala et al. argue convincingly on the basis of empirical evidence that the motives for BITs have changed over time: “As the density of BITs among peer countries increased, more countries signed them in order to gain legitimacy and acceptance without a full understanding of their costs and competencies.”

Thus, a plausible conclusion may be that the effects of IIAs may have carry through on those promises.” Tim Büthe & Helen Milner, The Politics of Foreign Direct Investment into Developing Countries: Increasing FDI through International Trade Agreements, 52 AM. J. POLIT. SCI. 741, 745-46 (2008). This is the investor-state dispute settlement mechanism.

42. Note the difference between the first and the second argument, which is due to the fact that the first argument refers to all investors, including those not covered by the BIT in question, while the second refers only to investors covered by the BIT. Id. at 744.


44. The impact of substantive protections provided by international investment treaties (“IIIs”) on the efficiency of decisions made by investors are analysed conceptually in Jonathan Bonnitcha & Emma Aisbett, An Economic Analysis of the Substantive Protections Provided by Investment Treaties, in YEARBOOK ON INTERNATIONAL INVESTMENT LAW AND POLICY 2011-2012 681, 688 (Karl P. Sauvant ed., 2012).

changed over time in parallel with the motives. 46

In terms of legal substance, practice shows that nearly all IIAs cover the following topics (see details in Table 1):

Table 1: The typology of Bilateral Investment Treaties protection

<table>
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<th>Type of IIAs</th>
<th>Description</th>
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| Liberalization of cross-border investment flows | Market access: Admission vs. establishment. Guarantee of free transfer of payments, of capital and returns, related to foreign investment, often qualified by exceptions in case of balance of payments problems.  
Non-discrimination principle | Principle of national treatment for foreign investors, but often subject to qualifications and exceptions.  
Regulatory constraint and investment protection | MFN treatment, subject to standardized exceptions.  
Access to international dispute settlement (Arbitration) | I and equitable treatment of foreign investors. Right of the host country to expropriate foreign investors, subject to the condition that expropriation is non-discriminatory and accompanied by adequate compensation. State-to-state dispute settlement provisions, and increasingly also investor-to-state dispute settlement.  
Source: Elaboration by the author. |

There has been a dramatic expansion in the number of international investment treaties. More than 5,900 treaties worldwide are dealing with investment issues. 47 During the last decade the increase was about forty percent. This complex network of treaties is sometimes referred to as a “Spaghetti Bowl.” Asian countries have been generally been leading the recent growth in IIAs. More than 2,800 BITs, involving 179 countries, have been signed. 48 Regarding arbitration under IIAs, there have been more than 450 known cases.

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48. The annual growth rate peaked in 2001, while in 2013 there were thirty-three new BITs. More than three hundred bilateral and regional PTIs have been signed, with fourteen new PTIs during the last year. The number of PTIs doubled between 2005 and 2014. See id.
The majority of cases (more than sixty percent) emerged after 2004, with forty-six claims in the last year alone. About ninety percent of cases are from investors of developed countries against developing countries. Out of 450 cases, 220 were concluded prior to December 31, 2013, with only twenty-six being concluded in 2014.\(^{49}\) Of the decisions, forty percent were in favor of the host country, while thirty percent were in favor of investors, and thirty percent settled.\(^{50}\)

IIAs that are BITs and PTAs with chapters on investment offer comprehensive rules on investment. The main purpose of IIAs is to ensure a stable and predictable environment for investment, through investor protection (including relative and absolute standards, as discussed below) and giving access to investor and state arbitration in a case of a breach of a treaty obligation. A few IIAs also provide market access for investors. An important goal for most states of their commitment to providing this protection is the attraction of foreign investment.

B. DEFINING THE SCOPE OF APPLICATION OF IIAS

From an economic policy point of view, IIAs have two rationales: firstly, the “inward” rationale of IIAs is to attract inward FDI and, secondly, the “outward” rationale of IIAs is to protect investors abroad.\(^{51}\) From a national viewpoint, the question arises whether these assumed effects of IIAs occur at all and (if so) how large these effects are.\(^{52}\) This is an empirical question. Needless to mention, the

\(^{49}\) UNCTAD, supra note 47.

\(^{50}\) Id.

\(^{51}\) Hence, the assumed effects of IIAs on FDI are twofold: (1) a positive effect on inward FDI is likely, because a host country provides an institutional element, which may not be available in other host countries and thus reduce the costs of investing in otherwise comparable locations, and (2) a positive effect on outward FDI is hypothesized, because FDI to riskier countries will increase, \textit{ceteris paribus}, if the institutional environment is improved and investors are protected and thus political risks are reduced. See Kenneth J. Vandevelde, \textit{Model Bilateral Investment Treaties: The Way Forward}, 18 SW.J. INT’L LAW 307, 310–12 (2011).

\(^{52}\) The United States Trade Representative’s office recognized that the goals of the United States Bilateral Investment Treaties Program were the protection of United States’ investments abroad, the encouragement and adoption in foreign countries of policies that treat private investment fairly, and the support of the development of international law standards that are consistent with the stated goals. \textit{See also} Jeffrey Lang, \textit{Keynote Address}, 31 CORNELL INT’L L.J. 455, 457 (1998).
above-described effects of IIAs on FDI can be appropriately assessed only in empirical studies if IIAs are adequately measured. Studies have only used information on the number of BITs of a country (newly concluded or cumulative). Because IIAs consist of many provisions, the implicit assumption that they are all equal cannot be justified. These differences in legal provisions are crucial when it comes to the application of IIAs in practice, e.g., in investment disputes or at a foreign market entry of a firm. Therefore, using only the number of IIAs implies imprecise measurement of differences between IIAs and hence they are important determinants of their effect on FDI. It is conceivable that investors are aware of publicly known investor-state disputes. The economic justification of IIAs is derived from two types of market failure, which explain the fact that sometimes investment policies lack credibility. As a consequence of the lack of credibility, an efficient investment, which would otherwise have taken place, is not carried out in the absence of a BIT. These arguments pertain to the existence of adverse selection and time inconsistency, also known as a holdup problem.


54. The lack of credibility is a very negative location factor for host countries. Broadly understood, it implies that the country is not seen as a reliable or safe place for foreign investors. In order to attract foreign investment, a prime objective of the host country is to find ways and means to correct or diminish the lack of credibility. This can take two forms: either adverse selection or time inconsistency. Adverse selection is based on a microeconomic perspective, and it refers to the fact that information about the true intentions of a government may be private, i.e., "when observers lack information about the beliefs and values that are motivating a government to pursue a certain policy, e.g., liberalizing capital flows," Tomz, supra note 38, at 2. Kerner uses the term "beliefs over a state's intentions," Kerner, supra note 39, at 74. This can be even more pronounced, if the government in question is a foreign government of a country, which lacks credible institutions, e.g., some developing countries. As South-South IIAs are increasing, this information asymmetry problem exists increasingly with respect to both treaty partners, while in a developed-developing country context it existed unilaterally for investors from the developed country only.

55. Both are well-known in the literature on economic policy. See Guzman, supra note 35, at 639–88. A brief exposition suffices here: How does the credibility problem derive from these two arguments, and are BITs an appropriate (efficient) answer to this problem? We discuss these problems here in light of the obsolescing bargain, i.e., "once a firm undertakes a foreign direct investment, some bargaining power shifts to the host country government, which has an incentive to change the terms of the investment to reap a greater share of the benefits." Büthe & Milner, supra note 41, at 743. Given the "obsolescing bargain" argument, it is noteworthy at the outset that this is neither a necessary nor a sufficient precondition for the credibility problem to arise; this is because there need not be an intent to deceive on the part of the host.
Given the fragmented international rules on investment, IIAs are considered to be the most comprehensive rules which cover the aspects of protection of investment and its related issues. The increased importance of IIAs necessitates the need to understand the scope of application of any IIA, with which a state has to comply. The four most important issues of comprehension relating to the scope of application in IIAs include: (1) what is the definition of “investor” and “investment”?; (2) when should the treaty obligations start?; (3) does the treaty cover only new investments after the treaty is in place or it is also valid for existing investments?; and (4) when does the treaty obligation end? On termination of the treaty should the obligations end or continue for a specified period of time for existing investments?

As discussed above, the classic economic concept of FDI as investment involves a transfer of funds or a commitment to transfer of substantial assets for a time period of more than a year, where profit is expected, the person transferring funds participates in management, business risk is assumed, and the investment is expected to contribute to the development of the host state.56

Most IIA definitions extend the scope of the agreement to a much broader conception of investment.57 Commonly, IIAs adopt a broad definition called an “Open Ended Definition” that includes every kind of asset (even intellectual property, etc.).58 More recently, 

Rather, adverse selection and time inconsistency aggravate the obsolescing bargain. Büthe & Milner argue that time inconsistency aggravated the obsolescing bargain. See Büthe & Milner, supra note 41, at 744. Bonnitcha and Aisbett mention that these terms are used interchangeably. See Bonnitcha & Aisbett, supra note 44, at 688.


58. See Tania S. Voon, Andrew D. Mitchell & James Munro, Intellectual Property Rights in International Investment Agreements: Striving for Coherence in National and International
a “Closed Ended Definition” has also been introduced in IIAs that limits investment to categories that are specified in a list. In such cases, however, the list could sometimes be quite long. In both cases, the definition may or may not require that investment must possess the characteristics of the classic concept of investment to qualify for protection.\textsuperscript{59} There are also some agreements where there are specific exclusions from the definition of investment.

III. EXPLORING THE PRACTICE OF TREATY SHOPPING

Treaty obligations apply only to the “investments” of “investors,” as defined in the treaty. The key legal question is thus, who is an investor and what is an investment? The \textit{Saluka Investments B.V. v. Czech Republic} tribunal expressed some sympathy for the argument that a company that has no real connection with a state party to a BIT and that is in reality a mere shell company controlled by another company, which is not constituted under the laws of that state, should not be entitled to invoke that treaty. The tribunal noted that this lends itself to abuses of the arbitral procedure, and to practices of “treaty shopping” that can share many of the disadvantages of the widely criticized practice of “forum shopping.” However, the predominant factor that must


\textsuperscript{59} For instance, the Pakistan-Malaysia Closer Economic Partnership 2007 does require that some of these characteristics are present. Article 88 requires that in addition to open ended definition, there is a “Qualification Note” to be applied for eligibility of an investment: “Where an asset lacks the characteristics of an investment, that asset is not an investment regardless of the form it may take. The characteristics of an investment include the commitment of capital, the expectation of gain or profit, or the assumption of risk.” Malaysia-Pakistan Closer Economic Partnership Agreement, Malay.-Pak., art. 88, Nov. 8, 2007, available at https://www.yumpu.com/en/document/view/37080283/malaysia-pakistan-wta/55.
guide the tribunal’s exercise of its functions is the terms in which the
parties to the treaty in question have agreed to establish the tribunal’s
jurisdiction.\textsuperscript{50} Importantly, this was revisited by \textit{Hulley Enterprises v. Russia, Yukos v. Russia}, and \textit{Veteran Petroleum v. Russia Interim Awards} on Jurisdiction and Admissibility, citing the \textit{Saluka} and \textit{Petrobarg} decisions, hold that the principles of international law, which have an unquestionable importance in treaty interpretation, do
not allow an arbitral tribunal to write new, additional requirements—which the drafters did not include—into a treaty, no matter how
auspicious or appropriate they may appear.\textsuperscript{61} Last but not least, \textit{Pac Rim Cayman v. Republic El Salvador} Decision on the Respondent’s
Jurisdictional Objections noted that a corporate restructuring
affecting a claimant’s nationality should not be considered as an
abuse of process if it was done in good faith before the occurrence of
any event or measure giving rise to a later dispute.\textsuperscript{62}

In order to address the issue, treaty shopping countries always
consider the following two main legal issues. First, what kind of
investments will benefit from the treaty obligation? Generally,
capital-exporting states would like to have a broad definition to
guarantee that their investors are protected regardless of the form of
their investment. Host states may be concerned that a broad
definition of investment creates a substantial risk of investor-state
claims.\textsuperscript{63} Second, what type of investment would a state like to
attract? Does a host state want to attract FDI or portfolio or both?
Each of the existing IIAs reflects a careful analysis of these elements.
Section A first reviews the main issues raised by treaty shopping
before looking at three disputes which shed light on the practices of
treaty shopping.\textsuperscript{64} Section B will focus on a case of upstream change.

\textsuperscript{50} Saluka Investments B.V. \textit{v.} Czech Republic, UNCITRAL, Partial Award, ¶¶ 240–41
(Mar. 17, 2006).

\textsuperscript{51} Veteran Petroleum Limited (Cyprus) \textit{v.} Russian Federation, PCA Case No. 228,

\textsuperscript{62} Pac Rim Cayman LLC \textit{v.} Republic of El Salvador, ICSID Case No. ARB/09/12,
Decision on Jurisdictional Objections, ¶ 2.47 (June 1, 2012).

\textsuperscript{63} Host states may also be concerned about whether there are any areas of state policy
that would be affected by the scope of the definition. For example, some countries would not
like to include state debt obligations in order to have flexibility to deals with such obligations in
the face of a balance-of-payments crisis.

\textsuperscript{64} See \textit{Roos van Os} \& \textit{Roeline Knottynerus, Dutch Bilateral Investment
Treaties: A Gateway to ‘Treaty Shopping’ for Investment Protection by
Section C analyzes the hypothesis of a downstream reorganization upon an already existing dispute. Finally, Section D reviews the hypothesis of a bad faith abuse of arbitration.

A. ISSUES RAISED BY TREATY SHOPPING

Given the number of agreements involved, the problem of treaty shopping becomes serious in the case of intersected agreements.\textsuperscript{65} Whereas the problem of nested agreements is limited to the choice between a limited number of agreements that include the same parties (a trilateral A-B-C agreement versus a bilateral B-C agreement), there are many options in the case of intersected agreements if treaty shopping becomes an issue.

However, treaty shopping is relatively less serious in the field of trade (in goods). This is mainly because there is an established concept of rules of origin ("ROO") for goods trade. It is natural that an export from Country B to Country A uses an A-B agreement to secure preferential access. There is still a possibility that an A-C agreement could be used for export from Country B to Country A, depending on the ROO stipulated in the A-C agreement. However, this certainly leads to more options for traders: a trader in Country B can use both an A-B agreement and an A-C agreement. Some may argue that the unexpected use of an agreement (the use of an A-C agreement by a trader in Country B exporting to Country A) could be problematic. Such an unexpected use of an agreement by traders leads to uncertainty from a policy perspective, but this essentially increases business opportunities. Moreover, an agreement’s “leaky” ROO that leads to an unexpected way of using the agreement simply

\textsuperscript{65} Because a large number of agreements have been signed in Asia and in the wider world, intersected agreements are a common phenomenon. The issue of intersected agreements occurs if one country signs an agreement with two different partners separately. It is very unrealistic to assume that those agreements have a similar legal regime on FDI. Thus, the issue of intersected agreements is aggravated by the indefinite number of agreements involved. If one country signs ten agreements with ten different partners, all those agreements constitute an intersected agreement problem. In the case of nested agreements, the number of the concerned agreements is relatively limited.
reduces the discriminatory effects of FTAs and is thus welfare-enhancing.

In the case of investment, treaty shopping problems seem to be more serious than in the case of goods because the origin of investor and investment is more ambiguous. IIAs usually employ a very broad definition of investment and the qualification for an investor is usually not demanding. Moreover, one should note that investors are mobile. This is especially true for multinational corporations (“MNCs”). Thus, MNCs have a temptation to partially relocate their bases, so that their investment assets are best protected by selecting the economy that has a favorable IIA with the hosting country of its investment. In short, treaty shopping leads to more legal options for investors.

This is a problem because IIAs usually involve ISD mechanisms under which a state could be sued by an investor. The uncertainty with regard to the origin determination of firms and the mobility of firms may lead to an unexpected ISD dispute, which is not favorable for governments. Interestingly, even a firm in a third country, which has no IIA with the concerned country, may file a claim against it.

In 2010, Australia introduced plain packaging for all tobacco products (drab dark brown with no trademarks) (Table 2). The purpose of the new bill is to discourage smoking initiation and to implement the Framework Convention on Tobacco Control (“FCTC”), as imposed by the WHO. However, this regulation, which aims to protect consumer health, was first challenged before Australian domestic courts without success. Now it is being challenged by the Philip Morris Incorporation (“PMI”) before an international tribunal for an alleged breach of the Hong Kong, China–Australia BIT. How did we reach the question whether


67. This agreement is technically titled “Agreement between the Government of Hong Kong and the Government of Australia for the Promotion and Protection of Investments.” See Philip Morris Asia Initiates Legal Action Against the Australian Government Over Plain Packaging. PHILIP MORRIS INT’L (June 27, 2011), http://www.pmi.com/eng/media_center
Australia’s plain packaging legislation violates a Hong Kong, China–Australia BIT? Actually, PMI launched proceedings via an Asian subsidiary even though it is an American company based in Virginia. Indeed, the USA–Australia FTA does not have ISD settlement and would not allow PMI to sue Australia for a breach of the USA-Australia FTA.

Table 2: Australian Tobacco Regulation Timeline

<table>
<thead>
<tr>
<th>April 2011</th>
<th>Australia announces plans for plain packaging consultation papers, draft legislation</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 21, 2011</td>
<td>PMI serves Notice of Claim to Australia to initiate negotiations before arbitration</td>
</tr>
<tr>
<td>November 21, 2011</td>
<td>Tobacco Plain Packaging Act 2011 and Trademarks Amendment (Tobacco Plain Packaging) bill receives final legislative approval; PMI announces it will pursue remedies via the Hong Kong, China-Australia BIT and domestically in the Australian courts</td>
</tr>
<tr>
<td>December 20, 2011</td>
<td>PMI files writ against the Australian government</td>
</tr>
<tr>
<td>March 2012</td>
<td>Ukraine complains to WTO</td>
</tr>
<tr>
<td>July 1, 2012</td>
<td>Tobacco legislation in force</td>
</tr>
<tr>
<td>October 2012</td>
<td>Australian High Court rejects PMI’s claim</td>
</tr>
<tr>
<td>February 2013, July 2013, March 2013, October 2013</td>
<td>Main arbitration hearings and international Award expected in 2015</td>
</tr>
</tbody>
</table>

Source: Author’s compilation.

As can be imagined, Australia never intended to give up its regulatory power to address health issues in the 1996 BIT concluded with Hong Kong, China. Equally unanticipated was the idea of a claim brought by an investor that is formally registered in Hong Kong, China but is commonly known as a powerful American MNC. Of course, one must expect a sovereign state such as Australia to anticipate such developments. However, one also perceives the considerable challenges raised by MNCs and their capacity to opportunistically relocate to new jurisdictions to benefit from more
favorable rights. One can also observe the policy ramifications since the potential use of investment arbitration to challenge tobacco regulations has become a source of controversy in TPP negotiations.  

The dispute between PMI and Australia is generating considerable debate. However, the practice known as investment structuring can be conducted. Investment structuring consists of giving the adequate legal shape and structure to an investment. For instance, a U.S. company wishes to contract with the Government of Pakistan to build, operate, and maintain a power plant in Pakistan. Although Pakistan has not entered into an investment treaty with the United States, the company may gain treaty protection under the Pakistan-Switzerland BIT by operating its investment through Switzerland. Its Swiss operations may also be protected by the Switzerland-Pakistan IIA. According to Clayton-Utz,

[there] may be circumstances where the host State of your investment has not entered into an investment treaty with your home State, be it Australia or another country. The good news is that you may still be able to obtain investment treaty protection. This may be achieved by structuring your investment through a third country that has entered into an investment treaty with the host State. In this way, you can make use of the protection available under that investment treaty to protect your investment in the host State.

It would be difficult to assess the amount of FDI that has been adjusted through legal investment structuring, but it is important to understand that this kind of legal service is provided by law firms from Hong Kong, China to Zurich, and including Tokyo, Singapore, and New York. This trend may lead to two opposite conclusions. The first would be to say that the concept of nationality is dead and irrelevant in the globalized economy. It is a tempting conclusion that

69. See Chapman & Freeman, supra note 67 (on the Phillip Morris dispute); Voon & Mitchell, supra note 67; see Philip Morris, Ltd. v. Prime Minister, JT Int’l SA v. Commonwealth [2012] HCA 43 (Austl.) (on Philip Morris’s unsuccessful claim against the Prime Minister of Australia).
was partly predicted by Karl Polanyi’s *Great Transformation.*71 However, one must also agree that states retain some power to legitimately control the actions of large MNCs. In this regard, the current investment scenario obliges states to find new tools to better anticipate the future application of their IIAs, especially intersected IIAs.

The problems caused by common member agreements differ from goods to investment. First, the status of nested and overlapped agreement brings more options to traders of availing tariff preferences, although this may lead to inconsistency of regulation in the case of international investment. Second, in the case of intersected agreements, the unexpected way of using FTAs basically reduces the negative aspect of FTAs, such as exclusiveness. In the case of investment, intersected IIAs would lead to unexpected investor-state disputes.

1. Legitimate Extension of Rights and Benefits by Means of the Operation of the MFN Clause

In 2000, the *Maffezini v. Spain* Decision on Objections to Jurisdiction noted, in discussing the MFN clause, that a distinction had to be made between the legitimate extension of rights and benefits by means of the operation of the clause, and disruptive treaty shopping that would play havoc with the policy objectives of underlying specific treaty provisions.72 However, it is true that, as underscored by the Tribunal in *Telenor v. Hungary* Award, the effect of the wide interpretation of the MFN clause is to expose the host state to treaty shopping by the investor among an indeterminate number of treaties to find a dispute resolution clause wide enough to cover a dispute that would fall outside the dispute resolution clause in the base treaty.73

73. See Telenor Mobile Communications A.S. v. Republic of Hungary, ICSID Case No. ARB/04/15, Award, ¶ 93 (Sept. 13, 2006).
2. Structuring (and Restructuring) of Investments to Gain Access to International Jurisdiction

The Cementownia v. Turkey Award observed that treaty shopping *per se* is not in principle to be disapproved of, but in some instances, it has been found to be a mere artifice employed to manufacture an international dispute out of a purely domestic dispute.74

Creating a legal entity in a host country cannot be in itself read as a bad maneuver. In the Tokelês v. Ukraine Decision on Jurisdiction, the majority distinguished between the creation of foreign legal personality for legitimate commercial planning purposes and the kind of conduct which the International Court of Justice (“ICJ”) noted (in Barcelona Traction); this conduct can lead to the piercing of the veil in municipal legal systems.75

The Aguas del Tunari v. Bolivia Decision on Objections to Jurisdiction held that it is not uncommon in practice, and in the absence of a particular limitation not illegal, to locate one’s operations in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability of a BIT.76

However, the Phoenix Action v. Czech Republic Award held that when a party makes an investment, not for the purpose of engaging in commercial activity, but for the sole purpose of gaining access to international jurisdiction, it does not engage in a *bona fide* transaction.77 The Mobil v. Venezuela Decision on Jurisdiction considered that to restructure investments only in order to gain

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74. See Cementownia “Nowa Huta” S.A. v. Republic of Turkey, ICSID Case No. ARB(AF)/06/2, Award, ¶ 117 (Sept. 17, 2009).
75. See Tokios Tokelês v. Ukraine, ICSID Case No. ARB/02/18, Decision on Jurisdiction, ¶¶ 54–55 (Apr. 29, 2004).
76. Aguas del Tunari, S.A. v. Republic of Bolivia, ICSID Case No. ARB/02/3, Decision on Respondent’s Objections to Jurisdiction, ¶¶ 320–21 (Oct. 21, 2008); Aguas del Tunari S.A. v. Republic of Bolivia, ICSID Case No. ARB/02/3, Declaration of José Luis Alberro-Semerena, ¶ 8 (Oct. 22, 2005) (finding that corporate restructuring results in the balance between the benefits and obligation of the host State becoming unpredictable).
77. Phoenix Action, Ltd. v. Czech Republic, ICSID Case No. ARB/06/5, Award, ¶¶ 142–144 (Apr. 15, 2009).
jurisdiction under a BIT for such disputes would constitute, to quote Phoenix Action, “an abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs” (but it finds no abuse of rights in restructuring investment to obtain BIT protection). 78

The BIVAC v. Paraguay Decision on Objections to Jurisdiction found that the claimant fills the requirements of being a juridical person having the nationality of one of the two parties to the BIT and no evidence had been put before it to indicate that the entity was created to take advantage of a favorable BIT. 79 Also, the BIVAC v. Paraguay Further Decision on Objections to Jurisdiction considered the fact that international groups of companies put different strategies in place and that legal structures cannot of themselves be considered to be inappropriate or even illegitimate, and cannot as such justify any suspicions of a hidden agenda as to a future litigation strategy. 80

The Millicom International Operations v. Senegal Decision on Jurisdiction noted that shares in the investment were held by Dutch nationals and this predated the arbitration by several years; even if it was possible, or even likely that the choice of the subsidiaries was also made considering the protection that their domicile could afford them, this fact alone could not constitute an abusive solution; 81 there would also need to be circumstances which would demonstrate that such choice was made unknown to the other party and under artificial conditions.

The Conoco Phillips Petrozuata v. Venezuela Decision on Jurisdiction and the Merits noted that the only business purpose of the restructuring at issue was to be able to have access to ICSID proceedings; however, at the time of the restructuring, no claim had

78. Venezuela Holdings B.V., ICSID Case No. ARB/07/27, Decision on Jurisdiction, ¶¶ 189, 205.


been made, and, subject to one qualification, none was in prospect at the time of the restructuring; in addition, a “major factor” in the tribunal’s view was that the claimant invested substantial sums of money after the restructuring; this was evidence “telling strongly against any finding of treaty abuse.”


### Table 3: Investment Awards Discussing the Issue of Treaty Shopping

<table>
<thead>
<tr>
<th>Award</th>
<th>References</th>
<th>Contribution</th>
<th>Legal basis for arbitral jurisdiction</th>
</tr>
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<tbody>
<tr>
<td>Mallozini v. Spain</td>
<td>Mallozini v. Spain</td>
<td>Distinction has to be made between the legitimate extension of rights and benefits by means of the operation of the clause, and disruptive treaty shopping that would plausibly occur with the policy objectives of underlying specific treaty provisions</td>
<td>Argentina-Spain</td>
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<td>Young Chi Oo v. Trading v. Myanmar</td>
<td>Young Chi Oo v. Trading v. Myanmar</td>
<td>Requirement of effective management of the investing company in the place of incorporation was primarily included in the 1987 ASI AN Agreement to avoid what has been referred to as “protection shopping”: i.e., the adoption of a local corporate form without any real economic connection in order to bring a foreign entity or investment within the scope of treaty protection</td>
<td>ASI AN Agreement for the Promotion and Protection of Investments</td>
</tr>
<tr>
<td>Final Award</td>
<td>Government of the Union of Myanmar</td>
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<td>ASI AN</td>
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<td>Case No.</td>
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<tr>
<td>CM v. Czech Republic</td>
<td>CM v. Czech Republic</td>
<td>Initiation of parallel treaty proceedings (under a different BIT offering similar protections) by a claimant’s shareholder is not an abuse</td>
<td>Czech Republic-Netherlands BIT</td>
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<td>Partial Award</td>
<td>The Czech Republic</td>
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<td>UNCITRAL</td>
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<td>Jokios v. Ukraine</td>
<td>Jokios v. Jokios v. Ukraine</td>
<td>Distinguishes between the creation of foreign legal personality for legitimate commercial planing purposes and the kind of conduct which the ICJ noted (in Barcelona Fraction) can lead to the piercing of the veil in municipal legal system</td>
<td>Lithuania-Ukraine BIT</td>
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<td>Decision on Jurisdiction</td>
<td>ICSID Case No.</td>
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<td>Aguas del Tunari v. Bolivia</td>
<td>Aguas del Tunari v. Bolivia</td>
<td>It is not uncommon in practice, and in the absence of a particular limitation not illegal, to locate</td>
<td>Bolivia-Netherlands BIT</td>
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<td>Republic of Bolivia</td>
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<tr>
<td>Decision on Objections to Jurisdiction</td>
<td>Bolivia, ICSID Case No. ARB 02/3</td>
<td>one’s operations in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability of a BIT.</td>
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<tr>
<td>Jelenor v. Hungary</td>
<td>Jelenor Mobile Communication S.A.S., The Republic of Hungary, ICSID Case No. ARB 04/15</td>
<td>The effect of the wide interpretation of the MFN clause is to expose the host state to treaty shopping by the investor among an indeterminate number of treaties to find a dispute resolution clause wide enough to cover a dispute that would fall outside the dispute resolution clause in the base treaty.</td>
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<tr>
<td>Phoenix Action v. Czech Republic</td>
<td>Phoenix Action, Ltd., The Czech Republic, ICSID Case No. ARB 06/5</td>
<td>When a party makes an investment, not for the purpose of engaging in commercial activity, but for the sole purpose of gaining access to international jurisdiction, it does not entitle it to an &quot;extra-petitory&quot; effect.</td>
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<tr>
<td>Cementownia v. Turkey</td>
<td>Cementownia &quot;Nova Huta&quot; S.A., Republic of Turkey, ICSID Case No. ARB(AF) 06/2</td>
<td>Treat shopping per se is not in principle to be disapproved of, but in some instances it has been found to be a mere artifice employed to manufacture an international dispute out of a purely domestic dispute.</td>
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Source: Elaboration by the author

**B. UPSTREAM CHANGES AND THE ISSUE OF ABUSE OF RIGHT**

In *Aguas del Tunari*, the claimant sued Bolivia under the Bolivia-Netherlands BIT. The dispute arose from the failed privatization of water and sewage services in the city of Cochabamba. The privatization was based on a forty year concession contract and it assigned to foreign companies the exclusive rights to provide water and sewage services in Cochabamba. Public opposition arose from the outset and then escalated. Public concerns related primarily to higher rates and prohibitions on communal wells.

It emerged during the arbitration that, prior to bringing its claim and as public opposition was developing, the foreign investor

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83. See generally *Aguas del Tunari*, S.A., ICSID Case No. ARB/02/3.
"migrated" corporate ownership of the privatized assets from the Cayman Islands to the Netherlands in order to have access to the Netherlands-Bolivia BIT. This was done without the permission of the Bolivian authorities which approved the original privatization. Aguas del Tunari v. Bolivia Decision on Respondent’s Objections to Jurisdiction found no support for an allegation of abuse of corporate form or fraud, but noted that under Rule 41(2) of the ICSID Arbitration Rules, it can consider on its own initiative at any stage of the proceeding whether the dispute or any ancillary claim before it is within its jurisdiction.84

In the Aguas del Tunari, S.A., after a water and sanitary sewer concession contract was concluded, the so-called “water war” started in 1999, and the local population demanded termination of the contract out of fear that prices would increase steeply.85 In the meantime, Aguas del Tunari changed its upstream ownership by transferring a fifty-five-percent ownership stake to a Dutch company in December 1999.

Figure 1. Corporate restructuring

![Diagram of corporate restructuring]

Source: Elaboration by the author

84. Aguas del Tunari, S.A., ICSID Case No. ARB/02/3, Decision on Respondent’s Objections to Jurisdiction, ¶ 331.
Four months later the concession was terminated. The tribunal thus accepted that at the time of restructuring the investor could not have contemplated the events which followed in the Spring of 2000, and it concluded that in casu the restructuring did not amount to abuse of process.86

The concept of abuse of the right to access ICSID Arbitration has begun to play an important role at the jurisdictional stage of ICSID proceedings, largely due to the widely adopted practice of treaty shopping by investors who restructure their investments in order to gain access to the jurisdiction of ICSID tribunals. Although the exact parameters of the principle are not yet established, the practices of ICSID tribunals provide a useful road map for future cases.87 In this respect, the Metal-Tech v. Uzbekistan Award noted that a breach of the general prohibition of abuse of right, which is a manifestation of the principle of good faith, may give rise to an objection to jurisdiction or to a defense on the merits.88 Also, the ConocoPhillips Decision on Jurisdiction and the Merits, advertsing to the case law of the ICJ, the WTO, and ICSID tribunals, noted that the principal reason that tribunals have given for not treating compliance with formal or technical requirements as being sufficient is to avoid the misuse of power conferred by law.89

The Aguas del Tunari tribunal adopted a flexible approach to the concept of corporate nationality under investment treaties. A majority of the tribunal allowed the claim to proceed in spite of the investor’s migration of its investment to the Netherlands in order to access arbitration under the Netherlands-Bolivia BIT.90 The Bolivian-appointed arbitrator dissented on this issue, concluding that the Bolivian authorities who approved the original investment should have been consulted about the change in corporate ownership.

86. The claim was settled after an international campaign to pressurize the U.S. company Bechtel, which was the main foreign firm involved in the privatization.
89. ConocoPhillips Petrozuata B.V., ICSID Case No. ARB/07/30, Decision on Jurisdiction and the Merits, ¶ 273.
90. Aguas del Tunari S.A., ICSID Case No. ARB/02/3, Decision on Respondent’s Objections to Jurisdiction, ¶¶ 334-37.
Similarly, in *Mobil v. Venezuela*, the tribunal distinguished between the already existing disputes relating to royalty payment and income tax payment and a future one relating to the termination of the concession. Only in the latter hypothesis was the restructure legitimate. Notably, in this case the process of restructuring started three years before the nationalization.

C. DOWNSTREAM REORGANIZATION UPON AN ALREADY EXISTING DISPUTE

Phoenix is an Israeli company that purchased two Czech companies, Benet Praha ("BP") and Benet Group ("BG"), in 2002, while these two companies were involved in ongoing legal disputes—BG with a private party, BP with the Czech fiscal authorities. The Czech Republic challenged the jurisdiction of the tribunal on the basis that Phoenix was an *ex post facto* sham Israeli entity created by a Czech national in order to establish diversity of nationality. The Czech Republic specifically asked the tribunal to decide whether a foreign entity could be created for the sole purpose of establishing diversity of nationality, thus triggering ICSID jurisdiction.

First of all, the *Phoenix Action* considered that the principle of good faith governs not only the relations between states, but also the legal rights and duties of those seeking to assert an international claim under a treaty: nobody shall abuse the rights granted by treaties, and more generally, every rule of law includes an implied clause that it should not be abused.

*Phoenix Action* held that the claimant committed an abuse of rights (it could be called a "détournement de procédure," consisting of its creation of a legal fiction in order to gain access to an international arbitration procedure to which it was not entitled. According to the tribunal in *Phoenix Action* "this alleged investment
was not made in order to engage in national economic activity, it was made solely for the purpose of getting involved with international legal activity. In its decision, the tribunal revisited the oft-cited “Salini test,” which attempts to determine whether there is an investment for the purposes of Article 25 of the ICSID Convention. The Salini test sets out four criteria for an investment to qualify as such under the ICSID Convention, i.e., (1) a contribution of money or other assets of economic value, (2) a certain duration, (3) an element of risk, and (4) a contribution to the host state's development.

The tribunal refused to rely exclusively on the Salini test. Instead, the tribunal concluded that for an investment to benefit from the international protection of ICSID, the following six elements had to be taken into account: (1) a contribution in money or other assets; (2) a certain duration; (3) an element of risk; (4) an operation made in order to develop an economic activity in the host state; (5) assets invested in accordance with the law of the host state; and (6) assets invested bona fide.

The Phoenix Action decision was a novel development insofar as the tribunal ruled that even in the absence of any provisions to that end in the relevant treaty, an investment will benefit from the protections of the treaty, and hence a tribunal will have jurisdiction, only if the investment is made in accordance with the law of the host state.

In the same vein, Venezuela Holdings v. Venezuela Decision on Jurisdiction found no abuse of rights in restructuring an investment to obtain BIT protection (but held that for preexisting disputes, to restructure investments only in order to gain jurisdiction under a BIT would, in the words of Phoenix Action, be an “abusive manipulation of the system”).

98. Phoenix Action, Ltd., ICSID Case No. ARB/06/5, Award, at ¶ 142.
99. Id. at ¶ 85. (“It is the Tribunal's view that the contribution of an international investment to the development of the host State is impossible to ascertain—the more so as there are highly diverging views on what constitutes "development." A less ambitious approach should therefore be adopted, centered on the contribution of an international investment to the economy of the host State, which is indeed normally inherent in the mere concept of investment as shaped by the elements of contribution/duration/risk, and should therefore in principle be presumed.”
100. Venezuela Holdings B.V., ICSID Case No. ARB/07/27, Decision on Jurisdiction, ¶¶
Jurisdiction noted that it is a perfectly legitimate goal, and no abuse of an investment protection treaty regime, for an investor to seek to protect itself from the general risk of future disputes with a host State; but the same is not the case in relation to preexisting disputes between the specific investor and the State.\footnote{101}

Recently, this approach has been confirmed in the \textit{Sanum Investments v. Laos} Award on Jurisdiction, which approved the finding in \textit{Agus del Tunari} and \textit{Phoenix Action}, and noted that the search for a convenient place of incorporation is common practice whether for fiscal reasons or for the network of investment treaties a country may have concluded.\footnote{102}

\subsection*{D. Bad Faith Abuse of Arbitration (\textit{Cementownia} Case)}

Seeking damages in amounts exceeding four billion dollars, Cementownia commenced arbitral proceedings against Turkey in the fall of 2006 for alleged breaches of the Energy Charter Treaty ("ECT").\footnote{103} Similar to the facts in parallel proceedings against Turkey which involve entities operated by the Uzan family, Cementownia asserted its standing to commence international arbitration on the basis of its alleged shareholdings in two Turkish electricity corporations, Çukurova Elektrik A.S. ("CEAS") and Kepez Elektrik Türk A.S. ("Kepez"), which saw their concession agreements with the Turkish Ministry of Energy terminated in June 2003.

Crucial to the jurisdictional question facing the tribunal was whether Cementownia had in fact acquired an interest in the two Turkish electricity companies prior to the termination of their concession agreements. In the face of such arguments, however, Cementownia never adduced any concrete evidence substantiating the precise timing of its share acquisitions. Consequently, after

\footnotesize{
\begin{itemize}
\item 102. Sanum Investments Ltd. v. The Gov’t of The Lao People’s Democratic Republic, PCA Case No. 2013-13, Award on Jurisdiction, ¶¶ 309–10 (Dec. 13, 2013).
\item 103. Cementownia “Nowa Huta” S.A., ICSID Case No. ARB(AF)/06/2, Award, ¶¶ 1–30.
\end{itemize}
}
numerous unsuccessful requests for the production of the original bearer share certificates, both parties sought dismissal of Cementownia’s claims on grounds that the tribunal lacked jurisdiction, albeit with different reasoning.

Cementownia requested the tribunal to base its reasoning solely on its inability to produce the original share certificates. In contrast, Turkey requested the tribunal to render an award which scrutinized all aspects of Cementownia’s standing to sue and to dismiss the claim with prejudice and with an award of damages and costs in its favor.

The tribunal made a number of findings that foreclosed Cementownia’s ability to recommence arbitral proceedings against Turkey. Given Cementownia’s failure to produce original share certificates evidencing its shareholdings in CEAS and Kepez, the inconsistent evidence with respect to the precise date of Cementownia’s share acquisition, the circumstances in which the share transaction occurred (i.e., via telephone and with rudimentary contracts), and the fact that Cementownia did not record the share transaction in its own financial statements in 2003 and 2004, the tribunal decided that Cementownia “. . . had not produced any persuasive evidence that could prove either its shareholding in CEAS and Kepez at the relevant time or that it was an investor within the meaning of the ECT.” In addition, the tribunal found that Cementownia’s claim was “manifestly ill-founded.” It also noted that Cementownia “. . . intentionally and in bad faith abused the arbitration; it purported to be an investor when it knew that this was not the case . . .” and was “guilty of procedural misconduct: once the arbitration proceeding was commenced, it . . . caused excessive delays and thereby increased the costs of the arbitration.”

After considering the arguments of both Cementownia and Turkey, the tribunal sided with Turkey and decided to dismiss the claim with prejudice in reason of the manifest bad faith of the claimant. Such reasoning was later confirmed by Malicorp Limited v.

104. Cementownia “Nowa Huta” S.A., ICSID Case No. ARB(AF)/06/2, Award, ¶86.
105. Id. at ¶ 149.
106. Id. at ¶ 157.
107. Id. at ¶ 159.
108. Id.
Egypt. As for the prejudice, the Cementownia tribunal is not unique since where the unsuccessful claimant has engaged in some form of abusive conduct, arbitral tribunals have ordered that the claimant pay all or a significant part of the respondent’s costs.

IV. MAPPING THE CAUSE OF TREATY SHOPPING: QUEST OF BENEFITS

The recent multiplication of IIAs offers a rich canvas against which foreign corporations can develop their legal strategy. The number of instruments are complemented by a rich, robust protection found in these treaties. Indeed, by the terms of these bilateral investment treaties, foreign investment is assured fair and equitable treatment, full security and protection, and no less than national and most-favored nation treatment. The foreign investor is assured of management authority and control. The terms of commitments entered into in respect of the foreign investment are to be observed. If there is a taking by the state of the foreign investment, by means direct or indirect, the state is treaty bound to pay prompt, adequate, and effective compensation.

In essence, there are two different types of standards of protection in IIAs: Section A will present the relative standards of treatment such as most-favored nation (“MFN”) and national treatment (“NT”). Section B explores the absolute standards of treatment, such as fair and equitable treatment (“FET”) and full protection and security (“FPS”). Section C analyzes the prohibition on expropriation without compensation. Section D looks at the importance of procedural rules and the role of investment dispute

110. See, e.g., Eur. Cement Inv. & Trade S.A. v. The Republic of Turk., ICSID Case No. ARB(AF)/07/2, Award, ¶¶ 182–86 (Aug. 13, 2009); Cementownia “Nowa Huta” S.A., ICSID Case No. ARB(AF)/06/2, Award, ¶¶ 173–78; Libananco Holdings Co. Ltd. v. Republic of Turk., ICSID Case No. ARB/06/8, Award, ¶¶ 557–69 (Sept. 2, 2011); Mr. Saba Fakes v. Republic of Turk., ICSID Case No. ARB/07/20, Award, ¶¶ 150–55 (July 14, 2010); Rachel S. Grynberg v. Gren., ICSID Case No. ARB/10/6, Award, ¶¶ 83.1–3.6 (Dec. 10, 2010); Phoenix Action Ltd., ICSID Case No. ARB/06/5, Award, ¶¶ 148–52.
settlement mechanism in the form of international arbitration. Finally, Section E reviews the remaining classic investment treaties’ provisions which are the limitations on the use of performance requirements and restrictions on the transfer of funds.\textsuperscript{112}

A. \textbf{Benefits in Terms of Conditions of Competition: Relative Standards of Treatment}

Countries conclude IIAs primarily for the protection and, indirectly, the promotion of foreign investment, and increasingly also for the purpose of liberalization of such investment. IIAs offer companies and individuals from contracting parties increased security and certainty under international law when they invest or set up a business in other countries party to the agreement. The reduction of the investment risk flowing from an IIA is meant to encourage companies and individuals to invest in the country that concluded the IIA. Allowing foreign investors to settle disputes with the host country through international arbitration, rather than only the host country’s domestic courts, is an important aspect in this context.

Non-discrimination, in the broadest sense, means that the host country must refrain from discriminatory actions against foreign investors in general or against specific groups of foreign investors. Bilateral investment treaties use two different terms in order to prevent the discriminatory treatment of investments: the MFN clause and the NT clause. We discuss below the applicability of these two types of treatment in bilateral treaties.

1. National Treatment

\textit{Asian Agricultural Products v. Sri Lanka} Dissenting Opinion of Samuel K.B. Asante, citing various publicists, noted that national treatment does not derive from customary law.\textsuperscript{113} According to investment treaties, NT requires that foreign investors are accorded

treatment that is no less favorable than that accorded to investors of the host state.\textsuperscript{114} NT means the obligation of contracting parties to grant investors of the other contracting party treatment no less favorable than the treatment they grant to investments of their own investors. Essentially, NT requires that countries do not discriminate against foreign investors in favor of domestic investors.\textsuperscript{115} The promise of NT in an IIA has to be assumed to be appealing to foreign investors.\textsuperscript{116} Conversely, some IIAs allow contracting states to have exceptions to NT in their legislation,\textsuperscript{117} which is relatively less appealing to foreign investment as the hypothesis for the absence of the NT provision.\textsuperscript{118}

“No less favorable” does not necessarily mean the same treatment. NT prohibits both discriminatory treatment expressed in law (\textit{de jure}) as well as discriminatory treatment resulting from the application the law in fact (\textit{de facto}). \textit{Bogdanov v. Moldova III} Final Award noted that discrimination can take many different forms; in

\textsuperscript{114} Champion Trading Co., ICSID Case No. ARB/02/9, Award, § 128 (stating that national treatment prohibits discrimination on the grounds of nationality).

\textsuperscript{115} The standard of treatment can be defined in two ways: “same” or “as favorable as” treatment or “no less favorable” treatment than the treatment they grant to investments of their own investors. The difference is subtle, but the “no less favorable” formulation leaves open the possibility that investors may be entitled to treatment that is more favorable than that accorded domestic investors, in accordance with international standards. Often the definition of NT is qualified by the inclusion of the provision that it only applies in “like circumstances” or “similar circumstances.” With the situations of foreign and domestic investors often not being identical, this language obviously leaves room for interpretation.

\textsuperscript{116} Agreement Between the Russian Federation and the Government of the Republic of Lithuania on the Promotion and Reciprocal Protection of the Investments, Russ.-Lith., June 29, 1991, see art. 1, para. 1, 2 ("1. Each Contracting Party shall accord in its territory to the investors, investments made by investors of the other Contracting Party and activities related to such investments fair and equal treatment … 2. The treatment, set forth in the paragraph 1 of this Article, shall be at least no less favourable than the treatment accorded by the Contracting Party to the investments and activities related to such investments of its own investors or the investors of third state.").

\textsuperscript{117} Agreement Between the Government of the Kingdom of Sweden and the Government of the Russian Federation on the Promotion and Reciprocal Protection of Investments, Swed.-Russ., Apr. 19, 1995, art. 3, para. 3 ("Each Contracting Party may have in its legislation limited exceptions to national treatment provided for in Paragraph (2) of this Article.").

\textsuperscript{118} An example of the NT obligation is in the US Model BIT. Treaty Between the United States of America and the Government of [Country] Concerning the Encouragement and Reciprocal Protection of Investment, U.S.-[Country], 2012, art. 3, para. 1 ("Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.")
the context of the treatment of foreign investments, however, a very frequent problem is discrimination on the basis of nationality.\(^{119}\)

In terms of the benefit of NT to an investor, it offers the investor a level playing field and protects the investor against discrimination. *Occidental Exploration v. Ecuador* Final Award stated that the purpose of national treatment is to protect investors as compared to local producers, and this cannot be done by addressing exclusively the sector in which the particular activity is undertaken.\(^{120}\)

However, for host states, it reduces the possibility of favoring domestic firms, unless exceptions or reservations are expressly introduced into agreements to allow discrimination as is commonly done in the case of government procurement, domestic subsidies to local business or taxation, etc. The U.S. Model BIT creates exclusions from MFN and NT for these kinds of government actions in addition to a general exception for security. Host states could also use a positive list, such that NT is only applicable to sectors covered in the list and not common to all. The scope of NT in this provision is limited, though quite broad. It is applicable only to the “establishment, acquisition, expansion, management, conduct, operation and sale or other disposition” of investments.

One issue is determining what the appropriate domestic comparator to the foreign investor is. Arbitration panels in investment cases have been inconsistent in terms of whether it is appropriate to interpret the concept of “like circumstances,” as in the provision above, in a manner similar to “like products” under WTO case law. More recent tribunals have adopted a broader approach. For example, under a broader concept even a domestic business in the same economic sector may not be enough to qualify as the appropriate comparator.

In *Bayindir (Turkey) v. Pakistan*, Pakistan contested whether the claimant should be compared to a domestic firm for the purposes of determining the treatment required under the NT obligation.\(^{121}\) This


\(^{120}\) *Occidental Exploration and Prod. Co. v. Republic of Ecuador*, LCIA Case No. UN3467 (London Court of International Arbitration), Final Award, ¶ 173 (July 1, 2004).

\(^{121}\) Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan, ICSID Case No. ARB/03/29, Award, ¶ 416 (Aug. 27, 2009).
issue arose when a claim was launched by the Turkish firm against the state which terminated a contract for a motorway project and awarded the work to a consortium of local and foreign companies. The Turkish firm said that the project it had been hired to do and that which the consortium was contracted to do were the same work and hence the complainant and the consortium were in a comparable situation. As a consequence, Pakistan had favored domestic firms over foreign investors. However, the tribunal noted that the local contractors who took over the project did so in a different context from Bayindir. Whereas the local contractors were given a more generous time allowance for completing the work, they were also offered different financial incentives, and had less experience with projects of this scope. As such, the local contractors could not be deemed to be in a “similar situation” to Bayindir. The tribunal agreed with Pakistan that the “Nature of the Contract” in each case was different. As a result, no breach of NT was found. The government’s action was a public policy measure that did not discriminate based on nationality.

Another example of a public policy measure not as discriminating between a foreign investor and a local business in like circumstances is a government measure to control environmental pollution by limiting the use of a particular technology that pollutes. Even if these measures affect only a foreign investor who uses that technology and not domestic investors who are not using this technology, it is likely that the foreign and domestic investor are not “in like circumstances.” The apparent discrimination could be justified as necessary to achieve a non-discriminatory public policy objective. The measure does not discriminate based on nationality, but rather on who pollutes.

Some states may like to limit the scope of NT as it applies to its sub-regional or sub-federal levels of government. The U.S. Model Agreement provides with respect to a regional level of government that the NT obligation is to provide treatment no less favorable than the treatment accorded in like circumstances, by that regional level of

122. Bayindir İmsaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan, ICSID Case No. ARB/03/29, Award, ¶ 389 (Aug. 27, 2009).
123. Id at ¶ 395.
government, to natural persons resident in and enterprises constituted under the laws of other regional levels of government of the party of which it forms a part, and to their respective investments. A regional level of government is only obliged to give the foreign investor treatment that it gives to national investors from outside the region. Finally, discriminatory intent is not relevant in most cases and it is quite hard to prove.\textsuperscript{124}

2. Most-Favored Nation Status

Under international law, the usual rule that derives from the principle of territorial sovereignty allows a state to prohibit the admission of foreigners and to deny the right to settle within its territory. This principle is reflected in many international instruments.\textsuperscript{125} In other words, under the bilateral investment treaty classic, the host country has the exclusive authority to decide whether the investment may be allowed on its territory.

Parkerings v. Lithuania Award discussed the relationship among MFN, national treatment, and discrimination, noting that differentiated treatment must be objectively justified.\textsuperscript{126} So, the MFN standard establishes, at least in principle, a level playing field between all foreign investors. The MFN treatment requires that a government does not discriminate among foreign investors from different

\textsuperscript{124} See supra note 122, at ¶ 390 ("If the requirement of a similar situation is met, the Tribunal must further inquire whether Bayindir was granted less favourable treatment than other investors. This raises the question whether the test is subjective or objective, i.e. whether an intent to discriminate is required or whether a showing of discrimination of an investor who happens to be a foreigner is sufficient. The Tribunal considers that the second solution is the correct one.").

\textsuperscript{125} Most countries are reluctant to grant to nationals and foreign companies an unqualified right to make investments in their territories, and for various reasons. Countries are often reluctant to admit foreign control of the most important means of production. Some countries may be concerned about the issue of foreign ownership in industries that are essential to national security, while other countries may be interested in foreign ownership on industries of particular importance in the development effort or that have a value and a special cultural significance. In other cases, domestic firms may require protection against foreign competition. The result is that many countries impose restrictions or conditions on the entry of foreign direct investment in specific industries. For these reasons, in general, a bilateral treaty does not give investors the right to make in the territory of the other contracting party.

\textsuperscript{126} Parkerings-Compagniet v. Republic of Lith., ICSID Case No. ARB/05/8, Award, ¶¶ 366-71 (Sept. 11, 2007).
countries. Unlike NT, all these IIAs include, at least in principle, the MFN standard.¹²⁷ MFN treatment does not require the host country to treat enterprises in different sectors or in different “situations” or “circumstances” in the same way; however, again there is a difficulty in determining what constitutes a “like circumstance.”¹²⁸

A first option consists of a drafting which gives the MFN a broad scope of application.¹²⁹ This first option is expected to be relatively more favorable to foreign investments. Conversely, restrictions are considered relatively less appealing to foreign investments. A second option limits the scope of the MFN clause through the inclusion of different possible restrictions. In order to identify these limitations, three issues can be raise: first, when there is a limited set of activities;¹³⁰ second, whether the MFN clause applies to third treaties

¹²⁷. BITs commonly provide that MFN treatment shall not apply so as to require that investors be given the same benefits as may be given to investors under the terms of customs unions, free trade zones, economic unions and the like. That provision ensures that the BIT does not become an impediment to regional economic integration. See Agreement Between the Government of Hong Kong and the Government of the Republic of Austria for the Promotion and Protection of Investments, H.K.-Austria, art. 4, Oct. 11, 1996 (MFN obligations shall not apply so as to require the host State to match any benefits resulting from any arrangements “designed to lead in future” to a regional customs, monetary, tariff or trade arrangement, or from any arrangement with any third state in the region “designed to promote regional cooperation in the economic, social, labor, industrial or monetary fields within the framework of specific projects”).


¹²⁹. Emilio Agustin Maftezini, ICSID Case No. ARB/97/7, Award, ¶ 38 (“In all matters subject to this Agreement, this treatment shall be no less favourable than that extended by each Party to the investments made in its territory by investors of a third country.”).

¹³⁰. Any limited set leads us to take the clause as narrow. Some MFN clauses, specifically those applying to pre-establishment, link the treatment to a limited set of activities (sometimes for both investors and investments or only for investments). See United Nations Conference on Trade and Development, New York, U.S. and Geneva, Switz., Nov. 2010, Most-Favoured Nation Treatment, UNCTAD Series on Issues in International Investment Agreements II, at 55, UNCTAD/DIAE/1A/2010/1 (“Each country shall accord to investors of the other Country and to their investments treatment no less favourable than that it accords in like circumstances to investors of a third State and to their investments, with respect to investment activities, ‘Investment activities’ being defined as ‘establishment, acquisition, expansion, management, operation, maintenance, use, possession, liquidation, sale, or other disposition of investments.’”); United Nations Conference on Trade and Development, New York, U.S. and Geneva, Switz., Dec. 1999, Most-Favoured Nation Treatment, UNCTAD Series on Issues in International Investment Agreements I, at 12, UNCTAD/ITE/1F/10 (Vol. III) (The right of establishment ensures that “a foreign investor, whether a natural or legal person, has the right...
providing for substantial liberalization of investment,\textsuperscript{131} and, third, whether the MFN applies to the investment only (and not to the investor).\textsuperscript{132}

An import of substantive standards of protection was allowed in \textit{Bayindir}, where the FET standard in the Pakistan-Switzerland BIT was allowed to be imported because it was considered more favorable than the Pakistan-Turkey BIT, which did not contain such a provision.

The main issue with using a MFN provision in a treaty to import standards from other treaties is that it could threaten the stability and coherence of obligations. The inclusion of a MFN clause in a new to enter the host country and set up an office, agency, branch or subsidiary (as the case may be), possibly subject to limitations justified on grounds of national security, public health and safety or other public policy grounds.

\textsuperscript{131} Some treaties indeed regulate potential interaction with third treaties as to preserve the arrangements entered into under the base treaty. For example, the Japan-Switzerland EPA 2009 establishes that the MFN clause does not apply to third treaties providing for substantial liberalization of investment. If such liberalization does occur, it would be subject to consultation with a view of incorporating it into the base treaty. For instance, the Most-Favoured-Nation Treatment of the Japan–Switzerland EPA reads in Article 88 that: “If a Party accords more favourable treatment to investors of a non-Party and their investments by concluding or amending a free trade agreement, customs union or similar agreement that provides for substantial liberalization of investment, it shall not be obliged to accord such treatment to investors of the other Party and their investments. Any such treatment accorded by a Party shall be notified to the other Party without delay and the former Party shall endeavour to accord to investors of the latter Party and their investments treatment no less favourable than that accorded under the concluded or amended agreement. The former Party, upon request by the latter Party, shall enter into negotiations with a view to incorporating into this Agreement treatment no less favourable than that accorded under such concluded or amended agreement.” Agreement on Free Trade and Economic Partnership Between Swiss Confederation and Japan, Switz.-Jap., art. 88, para. 3, Sept. 1, 2009.

\textsuperscript{132} Some BITs provide that MFN treatment applies only to investment. For example, the BITs between China on the one hand, and Cambodia, Qatar, and Brunei Darussalam, respectively, on the other hand. Some of China’s earlier BITs are limited in scope and cover only investments in their MFN Clause, without direct reference to “investment-related activities.” See Agreement on the Mutual Protection of Investments, China-Swed., art. 1, Mar. 29, 1982. Some IIAs cover only investments. There may be measures affecting the investor but not the investment; for example, a discriminatory entry or operational barrier applicable only to foreigners. This would have the consequence of excluding foreign individuals or companies from the MFN standard and limiting it to subsidiaries constituted as assets acquired under the legislation of the host state. This has been a common approach for countries like China and Australia. The Australia-Uruguay BIT serves a good example as its Article 4 defines MFN as: “Each Party shall at all times treat investments in its own territory on a basis no less favourable than that accorded to investments of investors of any third country . . . .” Agreement Between Australia and Uruguay on the Promotion and Protection of Investments, Austl.-Uru., art. 4, Mar. 9, 2002.
treaty may lead to the importation of provisions from old treaties. Similarly, obligations agreed to in new treaties could be imported into old treaties with MFN clauses. How is it possible to avoid this applicability? One way is to include exceptions and specific reservations in new treaties. Such treaties could also limit the scope of activities for applicability of MFN clauses by using a clause like the U.S. Model MFN, clause which is limited to specific activities.\textsuperscript{133}

The most important issue recently has been to what extent MFN in a treaty allows for the import of a standard from another treaty, which was not agreed between the two states contesting a dispute. In one case, it was argued by an Argentinean investor that the dispute settlement procedure in the Spain-Chile BIT was more favorable than the procedure agreed between Argentina and Spain, and therefore, the investor should be able to take advantage of the procedure because of the MFN clause in the Argentina–Spain BIT. The BIT between Spain and Argentina required an eighteen month delay before a claim could be made under the treaty, whereas in the BIT between Spain and Chile, there was no such requirement. The tribunal agreed with Argentina partly on the basis that, at the time of negotiations of the BIT, the eighteen month condition had been sought by Argentina and it was not usually included in Spain’s treaties, as was evidenced by the agreement with Chile. It supported its conclusion by noting that the overall goal of IIAs is to have favorable conditions for investment. This decision of the tribunal in \textit{Maffezini} permits claimants to cherry-pick the most favorable standards from other treaties.

\textsuperscript{133} We could also use a provision like the Canadian Model which contains an extensive carve-out from the MFN obligation. Annex III to Canada’s Model FIPA (“Exceptions from Most-Favoured-Nation Treatment”) provides as follows: “1. Article 4 [MFN] shall not apply to treatment accorded under all bilateral or multilateral international agreements in force or signed prior to the date of entry into force of this Agreement. 2. Article 4 shall not apply to treatment by a Party pursuant to any existing or future bilateral or multilateral agreement: (a) Establishing, strengthening or expanding a free trade area or customs union; (b) Relating to: (i) aviation; (ii) fisheries; (iii) maritime matters, including salvage. 3. For greater certainty, Article 4 shall not apply to any current or future foreign aid programme to promote economic development, whether under a bilateral agreement, or pursuant to a multilateral arrangement or agreement, such as the OECD Agreement on Export Credits.” Agreement Between Canada and [Country] for the Promotion and Protection of Investments, Can., Annex III, 2004 [hereinafter Canadian FIPA Model].
B. BEnEFITS IN TERMS OF RESPECT OF THE RULE OF LAW: THE FAIR AND EQUITABLE TREATMENT

IIAs usually include one or several general principles intended to provide overall criteria by which to judge whether the treatment given to an investment is satisfactory.\textsuperscript{134} The absolute standards found are the international minimum standard of treatment, fair and equitable treatment and full protection and security.\textsuperscript{135}

The FET is the most important (in theory and practice\textsuperscript{136}) of those general principles.\textsuperscript{137} Continental Casualty v. Argentina Award found that fair and equitable treatment is especially important for direct investments which are usually made for a considerable duration and whose profitability and economic contribution to the host country’s economy are dependent on them being treated by local authorities in a way which is coherent with the ordinary conduct of business activity.\textsuperscript{138} Also, Suez, Barcelona and Interagua v. Argentina observed that: (a) it is a vaguely and ambiguously defined standard, the scope of which is not defined in BITs; (b) it is a standard widely used in hundreds of BITs worldwide; (c) the terms defining the standard are flexible and apply to all types of investments and ventures; (d) it is a factual standard because its implementation is closely linked to the particular facts of each case so that judgment about what is fair and equitable cannot be formulated in the abstract but depends on the particular facts of the case; and (e) its extensive use in BITs, generality, and flexibility suggest that this is a standard developed by the contracting States as the basic standard of treatment

\textsuperscript{134} See Nicolas Angelet, Fair and Equitable Treatment, in 3 MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW 1094, 1095 (Rüdiger Wolfrum et al. eds., 2012).

\textsuperscript{135} ADF Group Inc. v. U.S. Award found that any general requirement to accord “Fair and Equitable Treatment” and “full protection and security” must be disciplined by being based upon State practice and judicial or arbitral case law or other sources of customary or general international law. ADF Group Inc. v. U.S., ICSID Case No. ARB(AF)/00/1, Award, ¶ 184 (Jan. 9, 2003).


\textsuperscript{138} Cont’l Cas. Co. v. Argentine Republic, ICSID Case No. ARB/03/9, Award, ¶ 254 (Sept. 5, 2008).
they are obliged to mutually grant to foreign investments protected under the BITs.\textsuperscript{139} In the same vein, \textit{Total v. Argentina} Decision on Liability noted that the undertaking of the host country to provide fair and equitable treatment to the investors of the other party and their investments is a standard feature in BITs, although the exact language of such undertakings is not uniform, and the generality of the fair and equitable treatment standard distinguishes it from specific obligations undertaken by the parties to a BIT.\textsuperscript{140}

This standard is not totally new, but it has been extensively applied since only 2000.\textsuperscript{141} It however lacks sufficient clarification. According to some, the vagueness surrounding this standard is intentional, in order to give arbitrators a certain amount of discretion.\textsuperscript{142} The clauses providing foreign investment with FET are widespread in IIAs.\textsuperscript{143} Thus, FET offers high protection when included in treaties. The FET favors FDI flows, while no FET might be less encouraging.\textsuperscript{144}

FET is considered a minimum standard of treatment. It is included in the vast majority of investment treaties. This is the provision most commonly invoked in dispute settlement and it is the basis of most successful claims. It has a broad scope and is an open-textured standard that is very hard to apply in practice.

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\textsuperscript{139} Suez, Sociedad General de Aguas de Barcelona S.A. v. Argentine Republic, ICSID Case No. ARB/03/17, Decision on Liability, ¶¶ 180-81 (July 30, 2010).
\textsuperscript{140} Total S.A. v. Argentine Republic, ICSID Case No. ARB/04/01, Decision on Liability, ¶ 106 (Dec. 27, 2010).
There are different ways to express it. Some treaties express it as a combination of FET with “full protection and security” and/or “general principles of International Law.” Some others follow the U.S. Model and limit FET only to Customary International Law (“CIL”). There is general consensus that it is a minimum standard of treatment for dealing with foreign investors, but as yet there is no consensus on what the standard requires. That is one reason why some treaties try to limit it to CIL. If it is not limited to CIL, then it would represent an autonomous standard. However, whether limited by CIL or an autonomous standard, the final interpretation is subject to the specific language used in the treaty.\(^\text{145}\)

In some cases, tribunals have adopted a broader view of the standard, such as interpreting FET as requiring states to act in compliance with the legitimate expectations of investors. Legitimate expectations may be based on or linked to three different elements: First, the necessary compliance with contracts; second, the legal regime at the time of the investment; and third, the general expectations of the foreign corporation.

Firstly, while compliance with contracts is a reasonable expectation, tribunals have held that not all breaches of contracts are breaches of FET. If a state acting in its sovereign capacity completely repudiated a contract, that action could be a breach of FET, but if a state terminated simply on the grounds of a commercial dispute, that would not be a breach of FET. For example, in *Waste Management v. United Mexican States*,\(^\text{146}\) a U.S. investor had a contract in Mexico for the collection of garbage. The city administration terminated the contract. Was it a breach of FET? The tribunal found that state acted

\(^{145}\) Waste Mgmt., Inc v. United Mexican States, ICSID Case No. ARB(AF)/00/3, Award, (Apr. 30, 2004). Taken together, the *S.D. Myers, Mondev, ADF* and *Loewen* cases suggest that the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard, it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant. Id. at ¶ 98. See also Eric van Eykken, *Fair and Equitable in CETA - Finally Defined?*, YOUNG ICCA BLOG (Mar. 6, 2014), http://www.young icca-blog.com/fair-and-equitable-in-ceta-finally-defined/.

\(^{146}\) Waste Mgmt Inc., ICSID Case No. ARB(AF)/00/3, Award.
only as commercial entity by terminating the contract due to the poor performance by the investor. Hence the tribunal did not find a violation of the FET obligation.

Secondly, investors have a reasonable expectation that the state will ensure that its rules are stable, predictable, and transparent. States must still have scope and freedom to respond to appropriate changes in policy measures as per the requirement of the domestic regime (e.g., in a democratic system, newly elected governments are under tremendous public pressure to make changes to polices already in place). The investor-state arbitration tribunals have not been consistent regarding the degree of flexibility permitted.

Thirdly, foreign corporations have a reasonable expectation that a state will be consistent and coherent in its application of law, comply with due process, and act in good faith. An example of a broad conception of the FET standard can be seen in paragraph 133 of *Técnicas Medioambientales Tecmed v. United Mexican States*, a case decided under the Spain-Mexico BIT:

> [T]o provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities... 147

Such a broad-based FET is very protective of investors, and subsequently this approach was followed in many cases. FET as a minimum standard of treatment is generally not subject to exceptions or reservations.

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147. *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, § 154 (May 29, 2003).*
As a minimum standard of treatment, there is a general consensus that the standard requires at least that the state not engage in bad faith, arbitrary treatment of investors, willful neglect of the interest of investors, or clearly unreasonable treatment of investors. Good faith requires that the state does not act with an intention to injure an investor. In Bayindir, it was alleged by the Turkish claimant in its case against Pakistan, regarding the termination of a motorway construction contract, that the cancellation of the contract and the award of the work to a consortium with domestic companies was not in good faith because the action was not based on problems with the claimant’s work but on the intention to confer a benefit on a consortium of local businesses. As a minimum standard, the state must treat investors in accordance with due process and exercise due diligence to prevent harm to investors. Due process includes requirements in administrative actions, like proper notice of government actions that affect an investor. Similarly, the state is under an obligation not to deny justice. Denial of justice is not any action of the courts deciding against investors, but rather involves a denial of a right to go to court, to refuse to entertain a claim, undue delay in judgment or the administration of justice in a deficient way, and clear misapplication of law. Sometimes the denial of justice is quite evident, such as in The Loewen Group v. U.S., where in civil judicial proceedings, a U.S. lawyer for the plaintiff made discriminatory remarks regarding the foreign defendant, effectively making the dispute a racial issue. The court failed to prevent the lawyer from making these prejudicial arguments and very substantial punitive damages were awarded against the defendant investor as a result.

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148. Inmaris Perestroika Sailing Maritime Services GmbH v. Ukraine finds that fair and equitable treatment is not limited to the standard required by customary international law. ICSID Case No. ARB/08/8. Excerpts of Award, ¶ 265 (Mar. 1, 2012). There is no requirement that the conduct be gross or shocking; a government act could be unfair or inequitable if it is in breach of specific commitments, if it is undertaken for political reasons or other improper motives, if the investor is not treated in an objective, even-handed, unbiased, and transparent way, or for other reasons. Id.

149. Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan, ICSID Case No. ARB/03/29, Award, ¶ 416 (Aug. 27, 2009).

150. The Loewen Group, Inc. v. U.S., ICSID Case No. ARB(AF)/98/3, Final Award, ¶ 149 (June 26, 2003).
In *Glamis Gold v. U.S.*, a 2009 case involving the minimum standard of treatment in NAFTA, which is tied to CIL, the tribunal described the standard, as “... a violation of the customary international law minimum standard of treatment,” as codified in Article 1105 of the NAFTA, requires an act that is sufficiently egregious and shocking—a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons—so as to fall below accepted international standards and constitute a breach of Article 1105. Such a breach may be exhibited by a “gross denial of justice or manifest arbitrariness falling below acceptable international standards,” or the creation by the state of objective expectations in order to induce investment and the subsequent repudiation of those expectations. The tribunal interpreted NAFTA Article 1105 to set a very high standard for FET claims that involves more than just a denial of justice. Applying this standard, the tribunal rejected a claim by a Canadian investor in the mining sector arising out of an action by the State of California to require the investor to back-fill a mine. This was a very strict view of the standard.

C. BENEFITS AGAINST EXPROPRIATION

Historically, the direct taking of foreign property was one of the most significant risks to foreign investors. *Metalclad v. Mexico* Award set out a general definition of expropriation:

> [It] includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or

151. *Glamis Gold, Ltd. v. U.S.,* UCSID, Final Award, ¶ 627 (June 8, 2009).
152. *Id.*
reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.\textsuperscript{154} So, outright takings are now considered rare in most parts of the world. However, another form of taking, referred to as indirect expropriation, has become increasingly important.\textsuperscript{155} If traditional international investment protection law was aimed at direct expropriations (towards the taking of a foreign investor’s assets), indirect expropriations (deprivations) have become a part of international legal investment protection rules and are in practice an important cause of treaty violations.\textsuperscript{156}

Indirect expropriation can be illustrated by several treaties. Although the specific wording may vary, most expropriation clauses have continued with the traditional approach of extending protection to those measures of the host country that may have an effect equivalent to expropriation or are tantamount to expropriation (other agreements use the term “indirect expropriations”).\textsuperscript{157} Some treaties

\textsuperscript{154} Metaleclad Corp. v. United Mexican States, ICSID Case No. ARB(AF)/97/1, Award, ¶ 103 (Aug. 30, 2000).


\textsuperscript{156} Indirect expropriations fall short of actual physical taking of property, but result in the effective loss of management, use or control, or a significant depreciation of the value of the assets of a foreign investor. There is, however, no clear definition of indirect expropriation. Despite a number of decisions of international tribunals, the line between the concept of indirect expropriation and governmental regulatory measures not requiring compensation has not been clearly articulated and depends on the specific facts and circumstances of the case. Of course, although there are some variations in the way some arbitral tribunals have distinguished legitimate noncompensable regulations having an effect on the economic value of foreign investments and indirect expropriation requiring compensation, examination reveals that, in broad terms, they have identified the following criteria which look very similar to the ones laid out by the recent agreements: (i) the degree of interference with the property right; (ii) the character of governmental measures, i.e., the purpose and the context of the governmental measure; and (iii) the interference of the measure with reasonable and investment-backed expectations. See Anne Van Aaken, International Investment Law Between Commitment and Flexibility: A Contract Theory Analysis, 12 J. INT’L ECON. L. 507, 510-12 (2009).

\textsuperscript{157} For example, treaties entered by France refer to: “measures of expropriation or nationalization or any other measures the effect of which would be direct or indirect dispossession.” Some UK treaties provide that expropriation also covers measures “having effect equivalent to nationalization or expropriation.” Other treaties, such as some of those concluded by Sweden, refer to “any direct or indirect measure” or “any other measure having the same nature or the same effect against investments.” The former United States Model BIT
do not mention the case for indirect expropriation; neither do they imply its coverage by the treaty.\footnote{158}{In this regard, Italy does not cover indirect expropriation in any of its IIAs, whereas the UK has dealt with it in only a few of them. Our hypothesis is that since most IIAs contain brief and general indirect expropriation provisions which focus on the effect of the government action, this has to be attractive to foreign investors. Conversely, when some IIAs do not protect investors against indirect expropriation, the effect expected on economic FDI flows is likely to be relatively weaker. See M. Som narajah, \textit{A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration, in Appeals Mechanism in International Investment Disputes} 39 (Karl P. Sauvant ed., 2008); Ari Afilalo, \textit{Towards a Common Law of International Investment: How NAFTA Chapter 11 Panels Should Solve Their Legitimacy Crisis}, 17 \textit{Geo. Int’l Envtl. L. Rev.} 51 (2004); Charles N. Brower, \textit{A Crisis of Legitimacy}, \textit{NAT’L J.I.}, Oct. 7, 2002, at B9; Charles N. Brower et al., \textit{The Coming Crisis in the Global Adjudication System}, 19 \textit{Arb. Int’l} 415 (2003); Charles N. Brower & Stephan W. Schill, \textit{Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?}, 9 \textit{CHI. J. INT’L L.} 471 (2009); Susan D. Franck, \textit{The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions}, 73 \textit{FORDHAM L. REV.} 1521 (2005).} Every state has the right to expropriate, so long as it is for a public purpose (e.g., road or rail construction), not arbitrary or discriminatory (applicable to both foreign and domestic investors), in accordance with procedural due process (i.e., in accordance with basic standards of fair procedure, proper notice, and access to a process to challenge the expropriation), and accompanied by adequate compensation.\footnote{159}{See, e.g., Compañía del Desarrollo de Santa Elena, S.A. v. Republic of Costa Rica, ICSID Case No. ARB/96/1, Final Award, ¶ 72 (Feb. 17, 2000) (Paragraph 72 of the award reads: “Expropriatory environmental measures—no matter how laudable and beneficial to society as a whole—are in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies; where property is expropriated, even for environmental purposes, whether domestic or international, the state’s obligation to pay compensation remains.”).} These requirements are generally expressed either in CIL or national laws, and the only issues are what state actions constitute expropriation and what is the standard for compensation.

There are two kinds of expropriation. Direct: This form of expropriation is relatively clear. It occurs when a state takes over an investor’s property. Indirect: Some sort of government action, other than which substantially affects an investor’s ability to use its
property, but there is no formal transfer of property to the state. It is less clear when an indirect expropriation has taken place.

Regarding indirect expropriations, IIAs must balance between a state’s rights to regulate for legitimate reasons without having to compensate an investor’s loss as a result of any such regulation and protecting an investor against losing substantial benefits of its property. The treaty needs to address the issue whether, as a result of government regulation (even if it was a bona fide regulation for public purpose), it could be considered an “indirect expropriation” and trigger an obligation to pay compensation if it had a substantial deprivation effect to an investor. The answer from arbitral cases is inconsistent. From a normative perspective, there is also a significant discrepancy across treaties.


163. See Joel C. Beauvais, Note, Regulatory Expropriations Under NAFTA: Emerging Principles and Lingering Doubts, 10 N.Y.U. ENVTL. L.J. 245, 248 (2002) (reviewing regulatory takings cases and finding that NAFTA tribunals have approached the doctrine “relatively
The discussion of expropriation cannot be complete without addressing the issue of the correct compensation standard. One common way in which the standard is expressed is prompt (without delay), effective (referring to the form in which it is paid which means, generally, a convertible currency), and adequate (fair market value, book value, or sometimes accounting value).

The other way advocated by some developing countries is appropriate or equitable compensation. This is generally understood to represent a lower standard which takes into account the host country’s ability to pay. Investors may not like this definition on the basis that it is less certain and less likely to fully compensate them for their loss. Another issue is whether damages should be reduced if an conservatively, placing significant limitations on the scope of government regulation subject to it”]; Rahim Molo & Justin Jacinto, Environmental and Health Regulation: Assessing Liability Under Investment Treaties, 29 BERKELEY J. INT’L L. 1, 24 (describing the standard in practice for finding a regulatory expropriation). For instance, the Canadian FIPA Model describes expressly what an indirect expropriation is. The Canadian Model states that an indirect expropriation is a measure or a series of measures that have an effect equivalent to direct expropriation, followed by details of a list of the factors to be considered. The parties confirm their shared understanding that: (a) indirect expropriation results from a measure or series of measures of a party that have an effect equivalent to direct expropriation without a formal transfer of title or an outright seizure; (b) the determination of whether a measure or series of measures of a party constitute an indirect expropriation requires a case-by-case, fact-based inquiry that considers, among other factors: (i) the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred; (ii) the extent to which the measure or series of measures interfere with distinct, reasonable investment-backed expectations; and (iii) the character of the measure or series of measures; (c) except in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith, nondiscriminatory measures of a party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation. See Canadian FIPA Model, supra note 133, at Annex B.13(I).

164. AIG v. Kazakhstan holds that, although there is much disagreement as to the appropriate standard of compensation, customary international law has consistently recognized that the expropriation of a foreign investor’s property, including contract rights, must be accompanied by “compensation”—the traditional standard being that such compensation be adequate in amount, be paid promptly, and be effective in the manner and form of its payment to recompense the owner for the loss of the property or investment. AIG Capital Partners, Inc., ICSID Case No. ARB/01/6, Award, ¶ 12.1.3.

165. Fuchs v. Georgia, citing Vivendi Award, holds that where the BIT is silent on the standard of compensation, Article 36 of the ILC Articles on State Responsibility indicates that the level of damages awarded in international investment arbitration is supposed to be sufficient to compensate the affected party fully and to eliminate the consequences of the state’s action. Ron Fuchs v. Geor., ICSID Case No. ARB/07/15, Award, ¶¶ 532–34 (Mar. 3, 2010).
investor has not taken steps to mitigate its loss. The last thing to address is whether this obligation of compensation for expropriation should be subject to reservation or exceptions. It may be argued on the investor’s side that, where there has been an expropriation, some obligation to compensate is required.

D. DISPUTE SETTLEMENT IN IIA

In order to ensure proper respect and conformity with investment rules regarding protected foreign investments, investment treaties provide various dispute-resolution mechanisms, “one of the most important of which is international investor-state arbitration which entitles an injured investor to sue the host government for damages because of a violation of treaty standards and rights.”

Gas Natural v. Argentina Decision on Jurisdiction considered that a crucial element of investment treaties—indeed perhaps the most crucial element—has been the provision for independent international arbitration of disputes between investors and host states.

On the basis of these provisions, disputes between an investor and a host state are settled by international arbitration rather than by the domestic courts of the host state (as would be the case otherwise). The host government’s consent to the jurisdiction of an international arbitration tribunal is granted ex ante in the form of an open offer in either the investment treaty or in its national law.

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169. See Andrew T. Guzman, The Cost of Credibility: Explaining Resistance to Interstate
few years, investment disputes brought before international arbitrators have multiplied and have raised attention by reason of the significant compensations host states have had to pay in some instances. An ISD mechanism is an incentive to invest because it provides as an ultimate resort access to international (neutral) jurisdiction.

There are two different kinds of dispute settlement procedures in IIAs: state-to-state dispute settlement and investor-state dispute (“ISD”) Settlement.

1. State-to-State Dispute Settlement

Most IIAs have established a process to address disputes between states, regarding the “interpretation or application” of the treaty. However, these procedures have rarely been used. The major issue is whether the scope of the procedures covers all provisions in IIAs or whether it excludes some of them. Most state-

Dispute Resolution Mechanisms, 31 J. LEGAL STUD. 303, 304 (2002); but cf. Andrew T. Guzman, A Compliance-Based Theory of International Law, 90 CALIF. L. REV. 1823, 1861–63 (2002) (arguing that the reputational cost of a violation of international law depends on several factors, including the extent to which other states know of the violation).

170. One notable example is the case of CME Czech Republic B.V. v. The Czech Republic, a UNCITRAL arbitration under the Netherlands–Czech Republic BIT, which resulted in an award and payment of $355 million to an injured investor, one of the largest awards ever made in an arbitration proceeding. CME Czech Republic B.V. v. The Czech Republic, UNCITRAL Arbitration Proceedings, Final Award, ¶ 371 (Mar. 14, 2003).

171. The Austria–Hong Kong agreement provides for a relatively broad scope of application of investor-state dispute settlement procedures without any condition: “any dispute . . . concerning an investment,” Agreement Between the Government of Hong Kong and the Government of the Republic of Austria for the Promotion and Protection of Investments, supra note 127, at art. 9. This approach is by far the most common in all IIAs. See Ian A. Laird, Interpretation in International Investment Arbitration - Through the Looking Glass. In A LIBER AMICORUM: THOMAS WALDE - LAW BEYOND CONVENTIONAL THOUGHT 151 (Jacques Werner & Arif Hyder Ali eds., 2009).


to-state procedures cover all IIA obligations, but some contain exclusions.\footnote{Pohl et al., supra note 166.}

The current U.S. Model BIT, for example, excludes the provisions regarding the maintenance of labor and environmental standards. Typically, state-to-state procedures require prior consultation between the states and then arbitration procedures in case there is no amicable solution after consultation.\footnote{See Anthea Roberts, State-to-State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretive Authority, 55 Harv. Int’l Econ. L.J. 1, 68–70 (2014) (concluding “that investment treaty rights are granted to investors and home states on an interdependent basis, and interpretive authority is shared between the treaty parties, investor-state tribunals, and state-to-state tribunals.”).} This state-to-state mechanism at least offers a platform to developing countries and less developed countries (“LDCs”) to require a developed country to engage with them regarding issues of interpretation. Arbitration procedures have not been traditionally transparent. Proceedings, notifications, and decisions have often not been made public.

2. Investor-State Dispute Settlement

This is a particular feature of IIAs which differentiates them from all other type of treaties.\footnote{Laird, supra note 171, at 157 (noting the “constant pressure that exists in investor-state arbitration between the fundamentally state-based system” and rights of individual investors under investment treaties).} Investors from one party state are permitted to seek financial compensation from the other party state through binding arbitration on the grounds that the other party state has failed to comply with its obligations under the treaty.\footnote{See Megan Wells Sheffer, Bilateral Investment Treaties: A Friend or Foe to Human Rights?, 39 Denver J. Int’l L. & Pol’y 483, 484 (2011) (describing how MNC-investors’ bargaining power is strengthened by BITs because these instruments provide them with minimum standards of protection).} Investor-state dispute settlement fulfills investors’ needs in many ways. First, it avoids exposure of the investor to the uncertainties of host state laws and regulations by creating a separate treaty-based set of rules to govern host state conduct.\footnote{See Stephen E. Blythe, The Advantages of Investor-State Arbitration as a Dispute Resolution Mechanism in Bilateral Investment Treaties, 47 Int’l L. & Pol’y 273, 275 (2013).} Second, it gives investors an alternative to the host state judicial system to seek relief from host state actions.

\footnotesize
\begin{itemize}
  \item \footnote{Pohl et al., supra note 166.}
  \item \footnote{See Anthea Roberts, State-to-State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretive Authority, 55 Harv. Int’l Econ. L.J. 1, 68–70 (2014) (concluding “that investment treaty rights are granted to investors and home states on an interdependent basis, and interpretive authority is shared between the treaty parties, investor-state tribunals, and state-to-state tribunals.”).}
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  \item \footnote{See Stephen E. Blythe, The Advantages of Investor-State Arbitration as a Dispute Resolution Mechanism in Bilateral Investment Treaties, 47 Int’l L. & Pol’y 273, 275 (2013).}
\end{itemize}
Third, an investor can determine when there has been a breach of a treaty obligation and launch a claim. Finally, it is unnecessary for an investor to rely on its home state espousing its claim—there may be various reasons why a state may not want to make a claim against another state in diplomatic relations.

Simultaneously, committing to ISD settlement could have advantages for a host state for at least three reasons. Firstly, it sends a positive signal to investors that it is committed to offering a predictable and secure investment regime. Secondly, it creates an incentive to develop domestic polices favorable to attracting new investment and maintaining ongoing investment, including policies that are predictable, certain, and transparent. Finally, it locks in pro-investment, market-opening reform by making it difficult to change domestic policy.

The system is however not perfect. The disadvantages for host states include the fact that in investor-state arbitration, investors pursue only their commercial interests and do not bother about host state policy goals or the public interest. This is not like state-to-state dispute settlement, where states may apply restraint with respect to pursuing claims. For example, states may not pursue an investor's claim against another state out of concern for their relationship with the other state or because they have measures similar to those that the investor is concerned about and which they would not want challenged. In addition, the cost of being a party to investor-state arbitration is high. Awards can be large and the costs of participating in an arbitration, even if the state is successful, are significant. Because of the high costs of investor-state arbitration, states may be reluctant to enact measures that might even be a breach of their obligations—this chilling effect is exacerbated by arbitration decisions that are inconsistent and that have adopted surprising interpretations of investment obligations. Third, investors cannot be made accountable for their actions in investor-state arbitration. The arbitration process gives rise to concerns regarding its legitimacy and democratic accountability, including: (a) lack of transparency; (b)

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lack of access to Civil Society (NGOs) to the process; (c) lack of knowledge on the part of tribunals regarding non-investment issues related to public policy considerations like human rights and the environment; and (d) limited knowledge on the part of tribunals about host state domestic laws and policies that must be interpreted in arbitration cases. Another key issue is that arbitral decisions have been inconsistent, thereby making obligations less predictable.180 Currently, there is a huge debate regarding how to address this issue. All the above concerns are of a serious nature and have led many states to reconsider the benefits of ISD arbitration of IIAs commitments in their present form.

This has led to some modifications in recent agreements. For example, the Canadian Model BIT (since 2003) and the U.S. Model BIT (since 2004) have adopted public disclosure requirements for most documents and awards, and the authority to allow amicus curiae submissions has been included. This transparency of process may add to the cost of arbitration, but it may also simultaneously increase the public attention to ISDs. This may lead to less use of process by investors and also impair the achievement of investment promotional goals of BITs, but they have currently become essential to the political legitimacy of investor-state procedures. Another approach recently taken by Australia is not to negotiate ISD settlement in future BITs. Similarly, India has declared that it will not agree to investor-state arbitration in the FTA that it is currently negotiating with the European Union (“EU”).

E. OTHER BENEFITS

Some IIAs also include provisions on performance requirements, provisions transfer of funds, and umbrella clauses, as discussed below. As only a minority of IIAs deal these issues, the discussions will be concise.

1. Performance Requirements

Performance requirements ("PRs") are the obligations imposed by host states as a condition of (i) admission of an investment of (ii) permitting the continued operation of an investment. PRs are imposed by the host countries to seek certain benefits associated with investment, but they have been controversial because of objections by investors. Host countries argue that PRs could bring substantial benefits to national development by requiring investors to export, to provide training, and to transfer technology. PRs restricting imports help to cover the risks of balance-of-payments problems resulting from excessive flows to purchase imports. However, the investors consider PRs against the basic principle of NT where they are applied to foreigners only and as imposing inefficient restrictions on how they conduct business.

Under the WTO Trade-Related Investment Measures Agreement ("TRIMS"), PRs affecting trade in goods in a manner contrary to GATT Article III (National Treatment) or Article IX (prohibitions of quotas) are prohibited. Under the GATS agreement in the WTO, PRs affecting trade in services in a manner inconsistent with GATS are prohibited. These include requirements relating to export performance by foreign investors, domestic content in products produced by foreign investors, domestic sourcing by foreign investors, restrictions on imports based on a foreign investors exports (trade balancing), and restrictions on a foreign investor’s access to foreign exchange based on the foreign exchange it generates through export sales (foreign exchange balancing).

Generally, we do not find restrictions on the use of PRs in BITs. However, U.S. and Canadian IIAs prohibit PRs imposed at the time of admission of investments and after admission. In both models, the list of prohibited PRs goes beyond TRIMS. This is because the performance requirements prohibited include requirements for technology transfer and product mandating as well as export performance, domestic content, domestic sourcing, trade balancing, foreign exchange balancing, in connection with the establishment.

acquisition, expansion, management, conduct, operation or sale of an investment. In this regard, these treaties may generate performance requirements disputes. Merrill & Ring v. Canada agrees with S. D. Myers v. Canada and Pope & Talbot v. Canada and held that measures which may have an incidentally adverse effect on the investor’s exports do not appear to be the kind of performance requirement prohibited by Article 1106, which needs to be directly and specifically connected to exports.

2. Transfer of Funds

A commitment of a host state to permit the transfer of funds into and out of a host state is of key consideration for an investor. For the host state, it is important to have policy space to monitor, regulate and in some cases control the flight of capital. In early treaties, there were no exceptions to transfer-of-funds commitments, even though in certain circumstances, like a balance of payments crisis, there are legitimate reasons to control capital flight.

182. Article 92 of the Pakistan-Malaysia Closer Economic Partnership Agreement prohibits performance requirements as envisaged in TRIMS. “For the purposes of this Chapter, the Parties reaffirm their commitments to the Agreement on Trade-Related Investment Measures in Annex IA to the WTO Agreement (hereinafter referred to as ‘TRIMS’) and hereby incorporate the provisions of the TRIMS, as may be amended, as part of this Chapter. A Party shall, upon notification by the other Party, promptly convene consultations with the other Party on any matter relating to this Article that affects the other Party’s investors and their investments.” Malaysia-Pakistan Closer Economic Partnership Agreement, Malay.-Pak., art. 92, Nov. 8, 2007. The effect of incorporating TRIMS obligations in an investment treaty is that it renders the obligations subject to the dispute resolution provisions in the agreement.


Although IMF rules prohibit controls on funds transfers related to current transactions, these rules do not apply to capital transactions (i.e., investment). GATS provisions prohibit controls on capital flows in connection with sectors in which a state has made specific commitments in its national schedule of commitments.\(^{187}\) Disputes regarding transfer of funds obligations rarely come up to investor-state arbitration.

The clauses on transfer payments are considered only by investors, but also by the host country as the most important in a bilateral treaty.\(^{188}\) They deal with one aspect of the relationship between the host country and the foreign investor on which their interests can be widely divergent.\(^{189}\) Whereas such clauses can and do differ from treaty to treaty, most IIAs stipulate that a wide range of payments and other-investment related funds shall have a right to be transferred out of the host state without delay, and, typically, in a freely convertible currency.\(^{190}\) Some IIAs allow deviation from the


188. See Dolzer & Schreuer, supra note 18, at 191-92.

189. The numerous investment claims brought against Argentina in the wake of its 2001 financial crisis have sparked a debate on the risks of not subjecting such guarantees to certain exceptions. While this particular crisis might have brought attention to this issue, it has always been controversial. Jeswald W. Salacuse thus stated in 1990: “[T]he negotiation of BIT provisions on monetary transfer is often one of the most difficult negotiations to conclude. Capital-exporting countries seek broad, unrestricted guarantees on monetary transfers, while developing countries press for limited guarantees, subject to a variety of exceptions.” See Lauge Skovgaard Poulsen, The Importance of BITS for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence, in Yearbook on International Investment Law & Policy 2009/2010 110 (Karl P. Sauvant ed., 2010). See also Duncan Williams, Policy Perspectives on the Use of Capital Controls in Emerging Nations: Lessons From the Asian Financial Crisis and a Look at the International Legal Regime, 70 Fordham L. Rev. 561, 614 (2001); Horacio Grigera Naon, Sovereignty and Regionalism, 27 Law & Pol’y Int’l Bus. 1073, 1077-78 (1996).

190. A very comprehensive agreement would normally cover: (i) “returns” on investment, including all profits, benefits, interest, capital gains, royalties, and management, technical
obligations enshrined in the transfer of funds provision in four cases.\footnote{191} Whereas this is most common in FTAs, which usually allow the introduction of safeguards motivated by the balance of payments or external financial difficulties,\footnote{192} exceptions of this nature are rather unusual in bilateral investment agreements. In constructing the BITSel, we made the hypothesis that a broad guarantee to allow outward transfers is likely to attract FDI while exceptions to the principle have to be considered as being relatively less encouraging to FDI. Indeed, from the foreign investors’ point of view, these clauses are key in investment treaties, as the ability to freely repatriate funds can be an important factor in their investment-decision process. This issue of a host state’s legitimate reasons for restricting funds transfer has been addressed through specific treaty provisions in more recent agreements with certain exceptions to the transfer-of-funds obligation.\footnote{193}

\footnote{191} One option is to subject the transfer clause to domestic laws, in which case the host state is free to limit the flow of capital out of its economy, for instance during economic crises, as long as it is done through law. See, e.g., Agreement for the Promotion and Mutual Protection of Investments, Port.-Bulg., art. 5, May 27, 1993. Another option is to allow exceptions to the free transfer of funds, but only during balance-of-payments difficulties and typically with a requirement that such restrictions should be necessary, non-discriminatory and on a temporary basis. See, e.g., Agreement for the Promotion and Protection of Investments, U.K.–Arg., art. 6, Dec. 11, 1990. Finally, some treaties include other major limitations that permit restrictions on capital flight, such as certain Chilean BITs attempting to restrict short term capital in- and outflows. See, e.g., Agreement for the Promotion and Reciprocal Protection of Investments, Chile-Austria, art. 4, Sept. 8, 1999. Other possible exception: host state should be able to prevent foreign investors from freely transferring revenues and capital out of its country if it were under economic difficulties.


\footnote{193} For example, the Canadian Model FIPA Article 14 on Transfer of Funds provides an example of a transfer-of-funds provision that contains exceptions for the various reasons that states may need to control funds transfer. It provides as follows: “1. Each Party shall permit all transfers relating to a covered investment to be made freely, and without delay, into and out of
3. *Umbrella Clause*

Some IIAs cover only those disputes which relate to an "obligation under this agreement", i.e., only for claims of BIT violations. Others extend the jurisdiction to "any dispute relating to investments." Some others create an international law obligation that a host state shall, for example, "observe any obligation it may have entered to," "constantly guarantee the observance of the commitments it has entered into," "observe any obligation it has assumed," and other formulations, in respect to investments. These provisions are commonly called "umbrella clauses." In essence, an

its territory. Such transfers include: (a) Contributions to capital; (b) Profits, dividends, interest, capital gains, royalty payments, management fees, technical assistance and other fees, returns in kind and other amounts derived from the investment; (c) Proceeds from the sale of all or any part of the covered investment or from the partial or complete liquidation of the covered investment; (d) Payments made under a contract entered into by the investor, or the covered investment, including payments made pursuant to a loan agreement; (e) Payments made pursuant to Articles 12 and 13; and (f) Payments arising under Section C [Investor-state arbitration]. Each Party shall permit transfers relating to a covered investment to be made in the convertible currency in which the capital was originally invested, or in any other convertible currency agreed by the investor and the Party concerned. Unless otherwise agreed by the investor, transfers shall be made at the market rate of exchange applicable on the date of transfer. Notwithstanding paragraphs 1 and 2, a Party may prevent a transfer through the equitable, non-discriminatory and good faith application of its laws relating to: (a) Bankruptcy, insolvency or the protection of the rights of creditors; (b) Issuing, trading or dealing in securities; (c) Criminal or penal offences; (d) Reports of transfers of currency or other monetary instruments; or (e) Ensuring the satisfaction of judgments in adjudicatory proceedings, . . .

Notwithstanding the provisions of paragraphs 1, 2 and 4, and without limiting the applicability of paragraph 5, a Party may prevent or limit transfers by a financial institution to, or for the benefit of, an affiliate of or person related to such institution, through the equitable, non-discriminatory and good faith application of measures relating to maintenance of the safety, soundness, integrity or financial responsibility of financial institutions." See Canadian FIPA Model, supra note 133, at art. 14.


196. An umbrella clause can be drafted in different ways. Compare Treaty for the Promotion and Protection of Investments, Ger.-Pak., art. 7, Nov. 25, 1959, 65 U.N.T.S. 28 ("Either Party shall observe any other obligation it may have entered into with regard to investments by nationals or companies of the other party.") with Agreement between Australia and the Republic of Poland on the Reciprocal Promotion and Protection of Investments, Austl.-Pol., art. 10, May 7, 1991 ("A Contracting Party shall, subject to its law, do all in its power to ensure that a written undertaking given by a competent authority to a national of the other Contracting Party with regard to an investment is respected.")
umbrella clause extends the scope of the application of a BIT, and it offers more protection to the investor. An umbrella clause extends the scope of application of BIT because it offers more protection to the foreign investor. If it contains an umbrella clause, it is a positive sign that we hypothesize will be an incentive for the investor to invest. Conversely, if there is no such umbrella clause, there will be a relatively lesser interest to use a BIT to invest.

V. CURTAILING TREATY SHOPPING: OPTIONS

One of the most important issues in an investment treaty is to define who is an investor whose rights are protected under the treaty. Investors must be related to the state party to the treaty other than the one complained against (the host state) in order to

Government of the Republic of Singapore and the Government of the Czech Republic on the Promotion and Protection of Investments, Sing.-Czech, art. 15, April 8, 1995 ("(2) Each Contracting Party shall observe commitments, additional to those specified in this Agreement it has entered into with respect to investments of the investors of the other Contracting Party. Each Contracting Party shall not interfere with any commitments, additional to those specified in this Agreement, entered into by nationals or companies with the nationals or companies of the other Contracting Party as regards their investments.").

197. For a discussion of the role of stabilization clauses in this respect, see generally Sam Foster Halabi, Efficient Contracting Between Foreign Investors and Host States: Evidence from Stabilization Clauses, 31 NW. J. INT'L L. & BUS. 261 (2011).

198. The SGS v. Philippines Decision on Jurisdiction holds that the text of the clause in the BIT is capable of applying to obligations arising under national law, e.g., those arising from a contract; indeed, it would normally be under its own law that a host State would assume obligations "with regard to specific investments in its territory by investors of the other contracting party." SGS Société Générale de Surveillance S.A. v. République of the Philippines, ICSID Case No. ARB/02/6, Decision on Jurisdiction, ¶ 115 (Jan.29, 2004).

199. "Another concern is treaty shopping by investors for the sole purpose of obtaining protection of BITs. Some of the new provisions included in the new model BITs address this problem directly. For instance, the new models include a Denial of Benefits Clause that allows a state to deny benefits of the treaty to an investor of the other party if 1) the enterprise has no substantial business activities in the territory of the other party, and 2) if persons of a non-party, or of the denying party, own or control the enterprise (i.e., shell companies). The extent to which these provisions will avoid treaty shopping still remains to be seen. The application of this type of clause has already caused a number of treaty interpretation problems. In the Norway Model BIT, the requirement of substantial business activities is directly contained in the definition of investor, which leaves it to tribunals to delineate the concept of substantial business activities. Also, the new Canada Model BIT provides that Most Favored Nation ('MFN') treatment does not extend to treatment accorded under existing treaties, and thus the MFN guarantees are applicable only to future treaty provisions." Gabriela Alvarez, Mapping the Future of Investment Treaty Arbitration as a System of Law; 103 AM. SOC'Y INT'L L. PROC. 328, 328 (2009).
benefit from the investor protection obligations in the host state. Section A reviews the law applicable to the definition of “investor.” The issue to be addressed is what connection is required between an investor and a state. Section B then looks at the definition of “investment” which further delineates the scope of application of the treaty which simultaneously determine the benefits of the potential treaty shopping. Section C examines the requirement of “investment legality” as a direct way to control treaty shopping. Section D analyzes the control of the foreign investment when it enters the host country. Section E explores the growing role of the denial of benefits clause in IIAs.

A. DEFINING THE FOREIGN CORPORATION AS INVESTOR

Typically, for natural persons, a national of a state party to a treaty or a citizen of the state is considered to be an investor of that state. The nationality is determined by the law of the state whose nationality is to be claimed to the extent not addressed in the treaty. Dual nationality, like in the case of many developing countries, may be permitted by state law. The possibility of dual nationality raises the question of whether dual nationals are allowed to be protected under a treaty if they have the nationality of the host state. The majority of treaties do not give an answer to this, but some attach a condition, such as considering what state a person has the most substantial connection as a way of defining nationality for the


201. “The rule of International Law [is] that in a case of dual nationality a third power is not entitled to contest the claim of one of the two powers whose national is interested in the case by referring to the nationality of the other power.” Salem (U.S. v. Egypt), 2 R.I.A.A. 1165, 1188 (U.S.-Egypt Special Claims Tribunal 1932) (holding that possession of dual U.S./Persian citizenship did not bar claims against Egypt). The same principle has been now embraced by the International Law Commission in its Draft Articles on Diplomatic Protection. See International Law Commission on Diplomatic Protection, art. 6, G.A. Res. 61/10, U.N. Doc. A/61/10 (2006) (addressing “multiple nationality and claim against a third State”).

purposes of the treaty. Residency in a specific state typically is not required.203

The next issue is, who is a legal or juridical person, such as a corporation? IIAs typically require that a legal person must be incorporated or organized under the domestic laws of a party in order to claim its nationality.204 It is quite simple for foreigners to meet this condition and to qualify for treaty protection. It is also easy for host states to determine whether a legal person qualifies for protection. The problems with such a definition are that it leads to a very broad protection and may need to be confined with some conditions. The need to further limit who qualifies as an investor depends on the domestic policy of the host state. Some states may not want further limits because they want to make it as easy as possible for investors to qualify for protection under the treaty.

Other states may be concerned about “treaty shopping.” Where simple incorporation in a country gives an investor the nationality of that country, there is a risk that investors may take advantage of treaty protection simply by incorporating a subsidiary in one party state for the purpose of making an investment in another party state. A domestic investor in one party state could even seek the protection of the treaty against its own government by channeling an investment through a subsidiary in the other party state back into the first party state. Some countries—for example, Mauritius—that want to be an international business hubs, are not concerned about this problem, but other countries may want to manage their exposure to treaty obligations and are interested in targeting only a narrow class of

203. See Champion Trading Co., ICSID Case No. ARB/02/9, Decision on Jurisdiction, ¶ 3.4.1 (discussing claimants’ argument that their involuntary Egyptian nationality should not be taken into account when interpreting the Convention).

204. See, e.g., Siemens A.G. v. Argentine Republic, ICSID Case No. ARB/02/8, Decision on Jurisdiction, ¶ 137 (Aug. 3, 2004) (stating although “there [was] no explicit reference to direct or indirect investment as such in the [Germany-Argentina BIT],” BIT covered indirect investment, notwithstanding that there were “interposed companies between the investment and the ultimate owner of the company”); accord Noble Energy Inc v. Ecuador, ICSID Case No. ARB/05/12, Decision on Jurisdiction, ¶ 77 (Mar. 5, 2008), “The Tribunal concurs with previous tribunals that have held that an indirect shareholder can bring a claim under the ICSID Convention and under a BIT in respect of a direct and an indirect investment. Failing any contrary wording, the BIT and the ICSID Convention encompass actions of indirect shareholders for their damages.” Id.
investors. To avoid treaty shopping, certain limitations are used in IIAs. These are as follows.

The requirement that the ultimate owners who control investment to be nationals of the home state party. This is a rare approach in IIAs but it would avoid misuse of protection. Such an approach is used in the Germany-Antigua and Barbuda BIT. Transnational corporations often have quite complex structures, and this makes it difficult to determine where ultimate control resides.

The requirement that a legal person must have substantial business activity, or its seat (location of effective management), head office, or some other significant connection, located in a state party. This is a common approach adopted in IIAs, but it is quite vague and it can lead to uncertainty when the issue is addressed in investor-state tribunals. Sometimes tribunals, in interpreting the requirement for the seat to be in a party state, have required a minimal connection. For example, in one case, it was held that if one director is resident in the jurisdiction and the corporation files its financial statement in that country, the seat of the corporation is in that country. Hence the application of this requirement can be hard to predict in practice.

Another alternative to address treaty shopping is a denial of benefits provision (see below).

B. DEFINING THE FOREIGN CORPORATION ASSETS AS “INVESTMENT”

While “investment” is generally considered a collection of resources for a given period used for future profits, the formal definitions found in international instruments have significant variations. Against this legal background, we make two hypotheses: (1) when the definition of “investment” is broad, there is a strong incentive to invest; and (2) when it is narrow, the contrary (less investments will be covered or protected) the risk is higher for the investor. In constructing the BITSel and coding the IIAs, we considered that the “asset-based”\(^{205}\) definition and the

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205. Such lists typically include five categories of material and immaterial assets: (1) movable and immovable property and any related property rights such as mortgages, liens or pledges; (2) various types of interests in companies, such as shares, stock, bonds, debentures or any other
“tautological”\textsuperscript{206} approach of the definition of investment provide a broad definition of investment, while the “closed-list”\textsuperscript{207} definition and other techniques that exclude certain assets and transactions from the definition\textsuperscript{208} tend to narrow the definition of investment and hence automatically reduce the scope of application of the BIT.

Policymakers framing the agreements are faced with further issues regarding the definition of investment.

\textit{Should investment be required to contribute to development?}\n
The issue is whether the contribution to development in IIAs should be made an eligibility criterion. Host states would like to be sure that investments would be protected only if they contributed to development. Investors would likely see such a requirement as creating substantial uncertainty regarding whether an investment would qualify for protection, in the absence of a standard definition of participation in a company, business enterprise or joint venture; (3) claims to money and claims under a contract having a financial value and loans directly related to a specific investment; (4) intellectual property rights; and (5) business concessions, that is, rights conferred by law or under contracts. See, e.g., Agreement Between the Government of Hong Kong and the Government of the Republic of Austria for the Promotion and Protection of Investments, supra note 127, at art. 1. Some BITs only refer to “all direct investment.” Agreement between the Republic of Bulgaria and the Republic of Hungary on Mutual Promotion and Protection of Investments, Bulg.-Hung., art. 1, June 8, 1994 (“The term “investment” shall mean every kind of asset... these assets shall refer to all direct investment made in accordance with the laws and regulations in the territory of the Contracting Party...”).

\textsuperscript{206} The tautological definition of “investment” can be flexible enough to apply to new types of investment that might emerge in the future. Numerous BITs concluded by the United States illustrate this approach, such as the BIT with Bahrain, which defines an “investment” as “every kind of investment” and not only “every kind of asset.” Bahrain Bilateral Investment Treaty, U.S.-Bahr., art. 1, Sept. 29, 1999.

\textsuperscript{207} The third approach that has emerged to avoid an excessively broad definition of “investment” is what is called a “closed-list” definition. It consists of an ample but finite list of tangible and intangible assets. Originally envisaged as an “enterprise-based” definition used in the context of U.S.-Canada FTA, this approach evolved towards the definition used in Article 1139 of NAFTA. See NAFTA, supra note 192, at art. 1139. It has been incorporated into the 2004 Canadian BIT model. See also Canadian FIPA Model, supra note 133.

\textsuperscript{208} In NAFTA, investment means: (a) an enterprise; (b) an equity security of an enterprise; (c) a debt security of an enterprise (i) where the enterprise is an affiliate of the investor, or (ii) where the original maturity of the debt security is at least three years, but does not include a debt security, regardless of original maturity, of a state enterprise; but investment does not mean, (i) claims to money that arise solely from (i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or (j) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h). NAFTA, supra note 192, at art. 1139.
of development. If such a requirement were included in a treaty, in the case of arbitration, a host state could claim that the tribunal did not have jurisdiction on the basis that the investment did not contribute to development.

Should portfolio investment or only FDI be included in the definition of investment? Because portfolio investments do not involve sunk costs and the time perspective is not long, if a portfolio investor is not happy with the treatment in the host country, it could sell and leave the country. This raises the issue of whether a treaty needs to protect, such as investment where an investor is free to leave at any time. The host state might not want to add any obligation to a portfolio, if as a result of inclusion of portfolio investment, investors would not be attracted. Another reason why host states would also not like to include portfolio investment is that it would add an obligation towards many investors creating a risk of multiple claims. On the other hand, small portfolio investors may also not like to bear the high costs of arbitration which may mitigate the risk of claims. It will be possible, in some cases, however, for portfolio investors that are affected in identical ways by host state action to bring their claims collectively. Third, there is an issue of how to define “portfolio investment.” The IMF definition of the term is more than 250 pages long which shows that it is not simple to do. One shortcut could be to define portfolio investment as less than a ten percent share in the equity of a business. Nevertheless, portfolio investment may be highly complementary to FDI and hard to distinguish from FDI in practice. Also, portfolio investment may be attractive to host states because it may supplement local sources of capital while leaving control in local hands.

Should assets not used for business purposes be excluded from the definition of investment? Another issue is that host countries sometimes want to exclude assets that are not used for business purposes. For example, investments in real estate for recreational purposes, which are not expected to generate profit and contribute towards the host country economy, could be excluded. Similarly, a host country may also have a policy of not allowing a specific area of residential real estate to be sold to foreign buyers. For a state to be permitted to do that in a manner consistent with an IIA, such
investments must be excluded from the definition of investment or be addressed in an exception clause.

What type of financial transactions are to be included in the definition? Generally short term investment like all portfolio investment is not excluded from the definition for the reasons discussed above. Some treaties, however, contain narrower limitations. One commonly used approach is to limit the definition of investment by imposing a condition on the eligibility of debt claims. For example, short term debt instruments with a maturity of less than three years may be excluded. Such short term investments may not be considered essential to development. Also, they are volatile and do not need protection. Similarly, the buying and selling of short term instruments is not like long term investments and hence they are not considered as being protected. Alternatively, an exception for prudential regulation may be used to preserve state policy-making flexibility to regulate financial flows, including short term investments. One specific approach is to introduce an exception in a Transfer of Funds provision (discussed below). A general exception from all treaty obligations could also be used to address a threat to national security or money laundering, etc.

C. REQUIRING THE LEGALITY OF INVESTMENT

The legality of investment is of great significance for all stakeholders, because generally the treaties offer protection to only those investments which are admitted “in accordance with law.” Most treaties require that if the investment is not admitted in accordance with the host state’s domestic law, then no protection is available under the treaty. This legality requirement is either introduced in the definition of investment or a provision defining the

209. See Bottini, supra note 10, at ch. 12 (discussing “The Legality of Investments under ICSID Jurisprudence”). By examining ICSID case law in detail, Bottini concludes that, although ICSID jurisprudence is unanimous in condemning acts of corruption in procuring international contracts, greater deference should be accorded to local courts, which are better equipped than international tribunals to deal with matters relating to corruption at local level. See generally MICHAEL WAIBEL ET AL., THE BACKLASH AGAINST INVESTMENT ARBITRATION: PERCEPTIONS AND REALITY (Kluwer Law Int’l ed., 2012).
scope of the agreement.\textsuperscript{210} It adds an incentive for investors to seek admission or approval for their investments.

The tribunal in \textit{Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines} explained in relation to the “in accordance with the law” provision being considered in that case:

\begin{quote}
[1]he [bilateral investment treaty (”BIT”)] is, to be sure, an international instrument, but its Articles . . . effect a renvoi to national law, a mechanism which is hardly unusual in treaties . . . . A failure to comply with the national law to which a treaty refers will have an international legal effect.\textsuperscript{211}
\end{quote}

Similarly, the tribunal in \textit{Tokios Tokeles} stated that, “[t]he requirement in Article 1(1) of the Ukraine-Lithuania BIT that investments be made in compliance with the laws and regulations of the host state is a common requirement in modern BITs.”\textsuperscript{212}

One example of a case where a tribunal denied jurisdiction over a claimant’s claims due to the investment’s failure to accord with the laws of the host state is \textit{Inceysa Vallisioletana, S.L. v. Republic of El Salvador}.\textsuperscript{213}

“In that case, the tribunal found that based on the language of the BIT and its travaux préparatoires, “the will of the parties to the [El Salvador-Spain] BIT was to exclude from the scope of application and protection of the Agreement disputes originating from investments which were not made in accordance with the laws of the host State.” The tribunal further found that the claimant had fraudulently misrepresented itself in a bidding process for...

\textsuperscript{210} See Gustav F W Hamester GmbH & Co KG v. Republic of Ghana, ICSID Case No. ARB/07/24, Award, ¶ 125 (June 18, 2010) (“[I]t is clear that States may specifically and expressly condition access of investors to a chosen dispute settlement mechanism, or the availability of substantive protection. One such common condition is an express requirement that the investment comply with the internal legislation of the host State. This condition will typically appear in the BIT where this is the instrument that contains the State’s consent to ICSID arbitration.”); see also \textit{Inceysa Vallisioletana, S.L. v. Republic of El Sal.}, ICSID Case No. ARB/03/26, Award, ¶ 184 (Aug. 2, 2006).

\textsuperscript{211} Fraport AG Frankfurt Airport Serv. Worldwide v. Republic of the Phil., ICSID Case No. ARB/03/25, Award, ¶ 394 (Aug. 16, 2007).

\textsuperscript{212} \textit{Tokios Tokeles}, ICSID Case No. ARB/02/18, Decision on Jurisdiction, ¶ 84.

\textsuperscript{213} \textit{Inceysa Vallisioletana, S.L.}, ICSID Case No. ARB/03/26, Award, ¶ 195; see also id. at ¶ 208 (“The Tribunal having decided that the consent given by the Kingdom of Spain and the Republic of El Salvador excludes investments not made in accordance with the laws of the host State, it must determine whether the investment that generated the dispute raised before it was made in accordance with the laws of ... El Salvador, and in order to determine thereafter whether this Tribunal is competent or not to hear the dispute submitted to it.”).
government contracts. As a result, the tribunal determined that it had no jurisdiction over the dispute because Inceysa’s investment did not meet the BIT’s requirement of legality.\textsuperscript{214}

This gives leverage to host states because they are not under an obligation to admit all investments, and they retain control of admission. Most treaties do not grant a right for foreign investors to enter and establish their operations (called a “Right of Establishment”), although some treaties, including those negotiated by Canada, the U.S. and Japan, do provide for a limited right of establishment. Developing or least developed countries that may have a weak regulatory system need to have a right to control admission, so that they can achieve their development. This issue is further discussed below.

The requirement for legality operates at the time of entry, and it does not mean that ongoing legality is a requirement for an investment to be eligible for protection under the treaty. If properly admitted, then subsequent irregularity is not likely to disqualify the investment for protection. Practically, this is required to protect the right of an investor in case of a subsequent change of government policy after the admission of investment. However, if the admission process is seriously defective, such as where an approval is based on false information or bribery, and the admission is achieved, then the investment may not be protected. Finally, the legality requirement does not mean that the definition of investment in domestic law overrides the definition in the treaty. Investments protected are defined as in the treaty, not as in domestic law.

“In accordance with the law” clauses, found in many investment treaties, are most often limited to requiring compliance with host-state law. However, there may be a case where a tribunal faced with an “in accordance with host state law” clause finds that it has jurisdiction, but also finds that the claimant’s claims are inadmissible due to the investment’s non-compliance with international legal principles. Though such an argument has yet to be explored by a tribunal, it appears theoretically possible by following the logic adopted by the \textit{Planta} tribunal, and, to an extent, the \textit{Hamester} tribunal. Further, most investment treaties

limit the “in accordance with the law” requirement to compliance with the law at the initiation of the investment. This makes sense given that the entirety of an investment procured or initiated through an illegal act is tainted by that illegality. That is, the investor’s hands are unclean with respect to the entirety of the investment. For the same reason, in assessing the admissibility of a claimant’s claims, the “in accordance with the law assessment” should also be made with respect to the initiation of the investment in question. Illegalities arising at some later stage of the investment may have an impact on certain claims based specifically on the illegal conduct, or on the amount of damages granted for a breach, but may not deem all of the claims of the investor inadmissible. There may be an instance, however, where, although the investment is procured legally, illegality pervades the investment to such an extent that all of the claims are in some way based on the claimant’s illegality. In such a situation, it should be open to a tribunal to deem all of the claimants’ claims inadmissible.\textsuperscript{215}

D. CONTROLLING THE ADMISSION OF THE INVESTMENT

Regarding the issue of admission and establishment, there are two different basic treaty models.

The first model is that there are no preestablishment rights, and that the host countries are not under any obligation regarding admission. The treaty standards apply only after the admission of investment, in accordance with the domestic law of the host states. This is a common approach, and it allows a country to regulate and establish criteria for admission which may change from time to time in accordance with its domestic law. This allows a host country to have discretion and a gatekeeper approach to determine in which sectors it should permit admission.

The second model is that the treaty includes a commitment to admit investments (a “Right of Establishment”). Some countries limit the commitment based on a positive or negative list approach, and some use exclusions based on domestic policy like protecting national security or public health. Some countries reduce commitments by permitting admission criteria and procedure like

\textsuperscript{215} See Moloo & Khachaturian, \textit{supra} note 214 at 1500-01.
Canada’s, the *Investment Canada Act* review, whereby a financial threshold is established and an investment review is conducted on any investment more than that above the threshold. To do that, there is a need to add a specific reservation. A right of establishment could be created through MFN and NT obligations that extend to the pre-establishment period (e.g., the NAFTA Model).216

In general terms, majority of BITs do not provide entry rights to foreign investors into their territory (Table 4). Only a very limited number of IIAs, such as the Japan-Thailand PTA and the Indonesia-Japan PTAs, provide establishment rights.

Table 4: Variations on establishment in investment treaties

<table>
<thead>
<tr>
<th>Treaty name</th>
<th>Regulation of entry of foreign investment</th>
<th>Type of regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>India-China BIT (2007) Article 3.1</td>
<td>“Each Contracting Party shall encourage and create favorable conditions for investors of the other Contracting Party to make investments in its territory, and <em>admit such investments in accordance with its laws and policy.</em>”</td>
<td>Admission clause</td>
</tr>
<tr>
<td>Taiwan-Thailand (1996) Article 4.1</td>
<td>“Each Contracting Party <em>shall seek and obtain approval from the authorities</em> of its relevant place to the effect that investments by investors of the other relevant place and the returns therefore shall receive treatment which is fair and equitable and not less favorable than that accorded to investments by investors of any third party.”</td>
<td>Treaties that require pre-approval of investments</td>
</tr>
<tr>
<td>Indonesia-Thailand BIT (1996) Article 2.1</td>
<td>“This Agreement shall apply to investments [. . .] to investments by investors of the Republic of Indonesia in the territory of the Kingdom of Thailand which have been specifically approved in writing by competent authorities of Thailand in accordance with the applicable laws and regulations of the Kingdom of Thailand and any laws amending or replacing them.”</td>
<td>Treaties that require pre-approval of investments with a triple condition: approval, in writing by relevant authorities</td>
</tr>
<tr>
<td>Japan-Thailand PTA (2007) Article 93</td>
<td>“[. . .] each Party shall accord to investors of the other Party and to their investments treatment no less favorable than that it accords, in like circumstances, to its own investors and to their investments with respect to the establishment, acquisition and</td>
<td></td>
</tr>
</tbody>
</table>

216. See NAFTA, *supra* note 192, at art. 1102 (“Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.”).
Most BITs provide only a best-effort provision in regard to the admission of foreign investments (see the India-China BIT). Such IIAs follow the well-known admission clause model, which allows the host country to apply any admission and screening mechanism for foreign investment which it may have in place and which therefore determines the conditions on which foreign investment will be allowed to enter the country. In these cases, in order to receive the

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217. On the issue of admission, the tribunal in Churchill and Planet v. Indonesia clarified that the admission requirement in both BITs is a one-time occurrence, a gateway through all investors must pass once; the admission requirement is consequently of a jurisdictional nature; it necessarily applies at the time of entry into the host State and not during the entire operation of the project. Planet Mining Pty Ltd v. Republic of Indonesia, ICSID Case No. ARB/12/14 and 12/40, Decision on Jurisdiction, ¶¶ 266–70, 274, 292 (Feb. 24, 2014).
protection of a BIT, the disputed investments have to be in conformity with the host state’s laws and regulations; but, usually, investments in the host state will only be excluded from the protection of the treaty if they have been made in breach of the fundamental legal principles of the host country.\textsuperscript{218}\footnote{See, e.g., Rumeli Telekom A.S. v. Republic of Kazakhstan, ICSID Case No. ARB/05/16, Award, ¶ 319 (July 29, 2008).} Furthermore, in \textit{White Industries Australia Limited v. India}, giving regard to the views of commentators, it was noted that the “encourage and promote” provisions are generally not seen to give rise to substantive rights (and they hold in any event that the specific obligations contended for by the claimant are not supported by the provision’s general wording).\textsuperscript{219}\footnote{White Industries Australia Limited v. The Republic of India, UNCITRAL, Final Award, ¶¶ 9.2.5–9.3.13 (November 30, 2011).}

There is another approach that is followed in the GATS and other agreements, in which a positive list approach is adopted requiring NT and prohibiting specific restrictions on market access such as limitations on foreign capital, requirements regarding the form of investment (like joint venture), or the total value of service operations. However, such prohibitions apply only to services listed by a country in its National Schedule of Commitments and they are subject to limitations written into the schedules.

Among the IIA’s adopting the admission clause, some of them deserve special mention in the way that they define the investment covered by the treaty because it has a significant impact on arbitration. Indeed, to date, a significant proportion of the small number of investment claims advanced against Asian states has failed on the question of jurisdiction involving a precondition of this sort. For instance, in \textit{Yaung Chi Oo Trading v. Myanmar} it was noted that the 1987 ASEAN Agreement requires that the investment must be “specifically approved in writing and registered by the host country and upon such conditions as it deems fit for the purposes of this Agreement”. Also, it was found that if a state unequivocally and without reservation approves in writing a foreign investment proposal under its internal law, that investment must be taken to be registered and approved for the purposes of the Agreement.\textsuperscript{220}\footnote{Yaung Chi Oo Trading PTE Ltd. v. Government of the Union of Myanmar, ASEAN

Further

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218. See, e.g., Rumeli Telekom A.S. v. Republic of Kazakhstan, ICSID Case No. ARB/05/16, Award, ¶ 319 (July 29, 2008).


220. Yaung Chi Oo Trading PTE Ltd. v. Government of the Union of Myanmar, ASEAN
illustrations are given, for instance, by *Gruslin v. Malaysia*\textsuperscript{221} and *Fraport*.\textsuperscript{222} These cases represent a specific kind of investment arbitration which could be seen as a “forced perspective” on case law involving Asian states, because they cannot result in any violation.

As it can be seen from Table 4 above, when it comes to IIAs in practice (e.g., the Indonesia-Thailand BIT and the Taiwan–Thailand BIT), some states—Thailand, Malaysia, and Indonesia—delineate the operation of substantive investment treaty protections by reference to compliance with an element of domestic law regulating the entry of foreign investment. Thailand, for instance, often obliges foreign investors to show that they have been granted specific approval (see the Thailand-Indonesia BIT) which can, in extreme cases, explicitly require an approval in writing by a competent authority (see the Thailand-Taiwan BIT). This considerably reduces the chances that an investment will be protected by the BIT and hence it decreases the exposure to investment claims.

Without clear proof of compliance with this one discrete element across a possible spectrum of entry conditions, foreign investment will not be protected by the BIT. An affirmative act of approval in writing is thus a necessary and sufficient condition for conferring treaty protection. This mechanism allows a state to calibrate its investment treaty exposure to the approval (which will often take the form of registration) of foreign investment under domestic law. It also explains why states such as Indonesia, Thailand, and Malaysia, which have concluded a large number of IIAs, have not been subject to a large number of claims. As a matter of fact, although Malaysia

\textsuperscript{221} I.D. Case No. ARB/01/1, Award, ¶¶ 53, 59 (Mar. 31, 2003).

\textsuperscript{222} In *Gruslin v. Malaysia* for instance, the single arbitrator declined to exercise jurisdiction over portfolio investment by a Belgian national that had incurred loss as a result of Malaysian capital controls imposed in response to the 1998 East Asian Financial Crisis. The arbitrator ruled that general approval by the Malaysian stock exchange for the listing of shares held by the Belgian national did not meet the required standard of an “approved project” under the BIT in question. See generally Philippe Gruslin v. The State of Malaysia, ICSID Case No. ARB/99/3, Award (Nov. 27, 2000).

\textsuperscript{222} *Fraport v. Philippines* considers, for jurisdictional purposes, that the “in compliance with” requirement is a jurisdictional limitation *ratione materiae* which relates the initiation of the investment and not the way it was subsequently conducted (although that may be relevant to a defense on the merits). *Fraport AG Frankfurt Airport Serv. Worldwide*, ICSID Case No. ARB/08/25, ¶¶ 334, 339–40, 344–45.
has concluded more IIAs than India or Pakistan, it has not faced many claims, partly because of the requirement of written approval.

E. DENIAL OF BENEFITS CLAUSE

Another alternative to address treaty shopping is a denial of benefits provision. This means that instead of incorporating requirements in the treaty definition of an investor, a host state can deny benefits of the treaty, if particular criteria, such as seat, ultimate ownership, or substantial business presence in a party state,\(^{223}\) could not be established by the investor.

Although the international community experienced a large increase in the number of international investment agreements in the 1980s and 1990s, discussion of the denial of benefits clause ("DOB clause") can be traced back to the 1950s. In 1956, Herman Walker Jr. noted, "The recent treaties signed by the United States, at any rate, indicate that this possibility of a 'free ride' by third-country interests is one to be guarded against . . . "\(^{224}\) This concept of a "free ride" by third party nationals is exactly what the denial of benefits clause seeks to prevent.\(^{225}\) While this idea was raised in 1950s scholarship, it is more relevant today than ever.

A number of disputes relate to the regime of a denial of benefits clause.\(^{226}\) In Salini Costruttori S.P.A and Istralde v. Morocco, the Tribunal declared that investment should contribute to the economy of the host state, otherwise it cannot be considered an investment.\(^{227}\)

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223. See 2004 U.S. Model BIT, supra note 47, at art. 17(2) ("A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of the other Party and persons of a non-Party, or of the denying Party, own or control the enterprise").


225. Id.


227. Salini Costruttori S.P.A and Istralde v. Kingdom of Morocco, ICSID Case No. ARB/00/4, Decision on Jurisdiction, ¶ 32 (Jul. 31, 2001) ("[O]ne may add the contribution to the economic development of the host State of the investment as an additional condition"). See Emmanuel Gaillard, Identity or Define? Reflections on the Evolution of the Concept of Investment in ICSID Practice, in INTERNATIONAL INVESTMENT LAW FOR THE 21ST CENTURY:
benefits or an Investment with ASEAN the Salini

yaung Chi Oo Trading highlighted that the requirement of effective management of the investing company in the place of incorporation was primarily included in the 1987 ASEAN Agreement to avoid what has been referred to as “protection shopping,” i.e., the adoption of a local corporate form without any real economic connection in order to bring a foreign entity or investment within the scope of treaty protection.228

More interesting, in Phoenix Action, an investor who was a Czech national had a dispute with the Czech government. He subsequently incorporated a corporation in Israel and transferred his investment to the Israeli corporation, with the goal of making the investment eligible for protection under the Czech-Israel BIT. As an Israeli firm, that investor launched a claim against the Czech Republic. A denial of benefits provision that contained a substantial “business activity in Israel” requirement could have been used to deny the benefits of the treaty to the investor.

What can be glanced from the above is that some cases have interpreted the denial of benefits provision to require that a state must give notice of a denial of benefits before a claim is filed. Whether this is a requirement will depend on how the “Denial of Benefits” provision is drafted.

228. “At the same time, the ACIA abandons many of the problematic aspects of the 1987 ASEAN IGA. The ACIA definitions of ‘investments’ and ‘covered investors’ are consistent with the broader definitions for such terms under the U.S. and German Model Bilateral Investment Treaties. The ACIA no longer follows the 1987 ASEAN IGA’s strict definition of an investor company as a ‘corporation, partnership or other business association, incorporated or constituted under the laws in force in the territory of any Contracting Party wherein the place of effective management is situated.’ Instead, the ACIA transposes the element of management or business operations in its denial of benefits clause, which is worded similarly to the denial of benefits clause under Article 17 of the Energy Charter Treaty.” Diane A. Desierto, ASEAN’s Constitutionalization Of International Law: Challenges To Evolution Under The New Asean Charter, 49 COLUM. J. TRANSNAT’L L. 268, 308 (2011).
VI. CONCLUSION

This Article has identified eight investment awards that openly deal with the issue of treaty shopping. It is a perfectly legitimate goal, and no abuse of an investment protection treaty regime, for an investor to seek to protect itself from the general risk of future disputes with a host State; but the same is not the case in relation to pre-existing disputes between the specific investor and the State. There is no abuse of rights in restructuring an investment to obtain BIT protection however, for preexisting disputes, to restructure investments only in order to gain jurisdiction under a BIT would, in the words of Phoenix Action, be an “abusive manipulation of the system”).

Also, compared to the more than three hundred awards rendered so far by international Tribunal, the quantitative analysis shows that treaty shopping is not a massive practice which would currently distorts the very reason of being of investment treaties and investment arbitration.

However, one must also assume that a number of Awards has not openly discuss the issue of treaty shopping while, perhaps, the practice may increase as indicated by the recent attempts of Philip Morris against Australia. It is true that the investment regime is now better known of lawyers and combined to the expansion of foreign investment throughout the world, one can reasonably hypothesize the increase of treaty shopping. This risk is tangible in light of the great variety of investment treaties and the different approaches chosen to determine the scope of some substantive rights. In other words, the absence of a multilateral agreement on investment further feeds the risk of treaty shopping. While the risk of treaty shopping is increasingly high, the Article pointed out at some legal solutions in the form of narrower definitions of investor and investment and/or stricter regimes on the admission and legality of the foreign

229. Phoenix Action v. Czech Republic notes that investments can be structured “upstream” to avail themselves of international protection as confirmed in Tokios Tokoles. Phoenix Action, Ltd., ICSID Case No. ARB/06/5, Award, ¶ 94.


231. Venezuela Holdings B.V., ICSID Case No. ARB/07/27, Decision on Jurisdiction, ¶¶ 198, 205.
investment. These solutions can also be combined to a clause on the
denial of benefits which however remain largely untested before
international tribunals. Implicitly, this Article also concludes that the
Contracting Parties to a BIT are free to define their consent to
jurisdiction in terms that are broad or narrow; once that consent is
defined, tribunals should give effect to it, unless doing so would allow
the ICSID Convention to be used for purposes for which it clearly
was not intended.\footnote{232}{Tokios Tokeles, ICSID Case No. ARB/02/18, Decision on Jurisdiction, ¶¶ 39–40, 20
ICSID Rev. 205.}