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Investor-State Arbitration

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A. Introduction

While investor-state arbitration remains a relatively new area of international law, the number of cases commenced under international investment agreements (IIAs) has grown exponentially over the past 10 years. This reflects in part the surge in the number of IIAs throughout the 1990s and early 2000s, but also an increasing awareness of the protections available.[1] For example, the 2016 UNCTAD World Investment Report noted that investors had initiated 70 known cases, the "highest number of cases ever filed in a single year," taking the total number of such publicly known cases to 696.[2]

Recently, investor-state arbitration (or investor-state dispute resolution - ISDS) has also been under the spotlight as a result of a series of attacks by politicians of many different political views in a wide range of countries from Australia to Venezuela.[3] Despite such criticisms,

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[1] For further discussion, see Grant Hanessian, Edward E. Poulton, Kabir A.N. Duggal. "Investor-State Arbitration," in *International Arbitration Checklists* (Grant Hanessian, Lawrence W. Newman, Eds.) (Juris 2016), Chapter 20.

[2] *World Investment Report 2016: Investor Nationality: Policy Challenges*, UNCTAD (United Nations 2016), p. 104.

[3] See *Bilateral and Regional Trade Agreements*, Australian Government Productivity Commission (November 2010), p. XXXVI (Chapter 14); *Report 165: Trans-Pacific Partnership Agreement*, Australian Joint Standing Committee on Treaties (November 2016), Chapter 6. Venezuela denounced the ICSID Convention in 2012 and terminated a bilateral investment with the Netherlands in 2008. See, eg, Luke Eric Peterson, "*Venezuela Surprises The Netherlands With Termination Notice For Bit; Treaty Has Been Used By Many Investors To 'Route' Investments Into Venezuela*," IA Reporter (16 May 2008). Indeed, some other countries have terminated or denounced BITs or MITs, however, most IIAs have sunset or survival clauses which guarantee that the provisions will remain in effect from 5 to 20 years after termination. See

ISDS can remain as a valuable tool, both for states to attract inward investment and for investors to protect those investments in the face of unlawful state interference.

IIAs are treaties entered into by two (bilateral) or more (multilateral) countries that offer a foreign investor substantive protections that can be enforced directly against the host state before an international arbitral tribunal (as opposed to domestic courts) in the event of a breach. Currently, over 3,000 bilateral investment treaties (BITs) have entered into force.[4]

Arbitration of investment disputes is also provided for in multilateral investment treaties (MITs) such as the Energy Charter Treaty (ECT), the North American Free Trade Agreement (NAFTA),[5] other free trade agreements, and certain states' domestic law regarding foreign investment.

The aim of IIAs is to provide protections for foreign investment by nationals and companies of one state in the territory of another state,

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generally *Denunciation of the ICSID Convention and BITs: Impact on Investor-State Claims*, UNCTAD Issues Notes No. 2, December 2010, pp. 3-4.

[4] A list of IIAs is available on the UNCTAD Investment Policy Hub, at http://investmentpolicyhub.unctad.org/IIA.

[5] Recent MITs include the Trans-Pacific Partnership between the Americas and Asia Pacific (TPP), the Transatlantic Trade and Investment Partnership between the US and the EU (TTIP) and the EU-Canada Comprehensive Economic and Trade Agreement (CETA). The text of the TPP has been finalized and is currently pending ratification. However, one the first acts of President Trump was to order that the US "withdraw" from the TPP. See "Trump executive order pulls out of TPP trade deal", BBC News (23 January 2017), available at http://www.bbc.com/news/world-us-canada-38721056. The future of the TPP remains uncertain because it effectively required ratification by the US to take effect. See TPP, Article 30.5(2). The text of the TTIP is currently being negotiated. The European Commission has recently proposed the creation of a judicial mechanism through standing courts, as opposed to *ad hoc* tribunals, to resolve investment disputes. See generally "EU Negotiating Texts in TTIP," available at http://trade.ec.europa.eu/doclib/press/index.cfm?id=1230. It remains to be seen what the final outcome will be. Finally, Canada and the European Union have recently signed CETA, which also envisions the creation of a new "Investment Court System". See "In Focus: EU-Canada Comprehensive Economic and Trade Agreement," available at http://ec.europa.eu/trade/policy/in-focus/ceta/.

thereby creating a more predictable and possibly more favorable investment climate. The unique feature of these treaties is that, although the treaty is concluded between states, it establishes the right for a national of one of the states (as opposed to the state itself) to bring proceedings against the other state.

B. Choice of the appropriate arbitral forum

The ISDS provisions in IIAs usually give the investor a choice of fora, including recourse to domestic courts or different types of international arbitration, such as:

- arbitration under the auspices of ICSID
- *ad hoc* arbitration (for instance, in accordance with the UNCITRAL arbitration rules)
- arbitration under the auspices of an institution like the International Chamber of Commerce (ICC) or the Stockholm Chamber of Commerce (SCC)

Unlike other arbitration institutions, ICSID is itself founded by a multilateral treaty drafted in 1965 specifically to promote international investment (the "Washington Convention" or the "ICSID Convention"[6]). ICSID is an autonomous international organization managed under the auspices of the World Bank. ICSID arbitration is a self-contained, delocalized system. Its awards are binding and not subject to any appeal or remedy other than those provided for in the ICSID Convention itself (annulment proceedings, which are intended to be limited and initiated largely on due process grounds). ICSID awards are also subject to a privileged enforcement mechanism: any award must be enforced by a contracting state as if it were a decision of its highest courts. ICSID awards are therefore not subject to

[6] See Database of ICSID Member States, available at https://icsid.worldbank.org/en/Pages/about/Database-of-Member-States.aspx.

confirmation or review by national courts, including the (already limited) test provided for by the New York Convention.

C. Establishing a tribunal's jurisdiction

For an investor to be able to benefit from the substantive protections contained in an IIA, the requirements for jurisdiction must be established. Further, if the dispute is arbitrated under the ICSID Rules, certain additional requirements developed pursuant to the ICSID Convention must also be met.

C.1 Careful consideration of the "fork-in-the-road" clause

Some IIAs provide that if the investor chooses to submit its claim to domestic courts or other agreed dispute resolution mechanism, it is precluded from relying on any of the other mechanisms available under the treaty. This is often referred to as a "fork-in-the-road" provision.[7] As a result, and without a careful review, an investor may (sometimes inadvertently) waive the right to submit its dispute to arbitration.

C.2 The notion of an "investment"

C.2.1 Under IIAs

What qualifies as an investment depends on the exact wording of the relevant treaty. However, IIAs generally define the term "investment" broadly, referring to "all kind of assets" and include an extensive,

[7] See, eg, Article VII (3) of the US-Egypt BIT that states: "In the event that the legal investment dispute is not resolved under procedures specified above, the national or company concerned may choose to submit the dispute to the International Centre for the Settlement of Investment Disputes ("Centre") for settlement by conciliation or binding arbitration, if, within six (6) months of the date upon which it arose: (i) the dispute has not been settled through consultation and negotiation; or (ii) the dispute has not, for any good faith reason, been submitted for resolution in accordance with any applicable dispute settlement procedures previously agreed to by the Parties to the dispute; or (iii) the national or company concerned has not brought the dispute before the courts of justice or administrative tribunals or agencies of competent jurisdiction of the party that is a party to the dispute."

non-exhaustive list of examples. A representative example is contained in the 2012 US Model BIT which provides:

> *"Investment" means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include: (a) an enterprise; (b) shares, stock, and other forms of equity participation in an enterprise; (c) bonds, debentures, other debt instruments, and loans; (d) futures, options, and other derivatives; (e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; (f) intellectual property rights; (g) licenses, authorizations, permits, and similar rights conferred pursuant to domestic law; and (h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.*

C.2.2 Under ICSID

Although arbitration under ICSID Rules is only possible in the context of an "investment," the ICSID Convention does not define this term. Over the years, ICSID tribunals have proposed certain characteristics that in their view indicate the existence of an investment under the ICSID Convention. The most famous formulation was in *Salini v. Morocco* case, where the tribunal stated:

> *The doctrine generally considers that investment infers: contributions, a certain duration of performance of the contract and a participation in the risks of the transaction. In reading the Convention's preamble, one may add the contribution to the economic development of the host State of the investment as an additional condition.* [8]

[8] *Salini Construttori S.P.A and Italstrade S.P.A v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction (23 July 2001), paragraph 52.

This is often referred to as the "*Salini* test." Notwithstanding the fact that there is no precedent system in international arbitration (including international investment arbitration), the *Salini* test is often used as a reference point by tribunals. Some tribunals follow it relatively strictly, while others choose to amend it, particularly the requirement of economic development of the host state. This is undoubtedly an area of uncertainty the investor must consider when deciding whether ICSID is the right forum to decide the dispute.

C.3 The notion of a foreign "investor"

C.3.1 Under IIAs

The test for being a foreign "investor" under any IIA will depend on its terms. However, generally speaking, an investor must possess the nationality of one contracting state to the BIT or MIT and bring proceedings against another contracting state of that same treaty. Any investor considering bringing proceedings must ensure it complies with the nationality requirements set out in the treaty. For companies, this is often a test of incorporation (ie, a company incorporated in a country will have the nationality of that country). Where treaties simply refer simply to a place of incorporation, tribunals will be reluctant to pierce the corporate veil, even if the majority shareholders are nationals of the host state itself.[9] This permits a certain degree of treaty planning, a practice whereby companies route their investment through special purpose vehicles in order to benefit from investment protections. However, certain treaties require that a company be controlled from, or demonstrate business activity in, the country of incorporation in order to qualify.

[9] *KT Asia Investment Group B.V. v. Republic of Kazakhstan*, ICSID Case No. ARB/09/8, Award (17 October 2013), paragraph 116 ("[under the applicable BIT,] a legal person constituted under the law of a Contracting Party is a national of that state. KT Asia is a legal person constituted under the law of the Netherlands. As a result, it is a Dutch national under the nationality test of the BIT.")

C.3.2 Under ICSID

In addition to the nationality requirements set out in the applicable IIAs, in the event the parties are contemplating ICSID proceedings, the requirements of the ICSID Convention also need to be met. There are two important aspects. First, the investor must possess the nationality of another contracting party on the date on which the parties consented to submit the dispute to arbitration.[10] Second, the ICSID Convention, in certain circumstances, permits a locally incorporated company to be treated as possessing the nationality of its foreign parent because of "foreign control."[11]

C.4 Additional requirements in IIAs: cooling-off periods and domestic litigation

Many IIAs provide that arbitration can be initiated only after a certain "cooling-off" period has lapsed. For example, Article VII of the US-Argentina BIT permits recourse to international arbitration after "six months have elapsed from the date on which the dispute arose." The purpose of such a period is to allow the parties to explore an amicable settlement or to allow the host state to change the legislation or administrative measures that may have given rise to the claim.

Another example is where investment treaties require that the dispute first be heard by domestic courts. This obligation is sometimes limited in time. If domestic courts do not issue a final decision within this period, the investor may initiate investment arbitration proceedings.

D. Substantive protections

The key advantage of an IIA of course is that it provides an investor with substantive rights. The precise nature and scope of protections differ in each treaty and parties must be careful in reviewing the terms of any such rights. There is no precedent in this area and each treaty will be interpreted on its terms according to international law and on

[10] ICSID Convention, Article 25(2)(a)-(b).
[11] ICSID Convention, Article 25(2)(b).

the specific facts of the dispute. This being said, some key protections are included in the vast majority of IIAs and contain similar wording, as a result of which certain trends in the arbitration practice have emerged.

D.1 No expropriation without compensation

IIAs do not prohibit expropriation in itself; however, they set out strict requirements that must be met for it to be lawful. Such requirements are usually explicitly set out in the IIA and include: a public interest or public policy; due process; non-discrimination; and the payment of prompt and adequate compensation. As an example, Article III of the Kazakhstan-Turkey BIT provides:

> *1. Investments shall not be expropriated, nationalized or subject directly or indirectly, to measures of similar effect except for a public purpose, in a non-discriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law and the general principles of treatment provided for in Article II of this Agreement.*
>
> *2. Compensation shall be equivalent to the real value of the expropriated investment before the expropriatory action was taken or became known. Compensation shall be paid without delay and be freely transferable ...*

Failure to meet any of these conditions will likely cause an expropriation to be unlawful. Expropriation need not be direct. It can sometimes be indirect through, for example, legislative or taxation measures, as a result of which the value of an investment is lost without the title being formally transferred. Expropriation may also result from a series of individual measures that effectively amount to a taking, commonly referred to as "creeping expropriation." The crucial determinant is the extent to which the measures taken have deprived the owner of the normal control over their property or substantially deprived the owner of the economic value of their property.

The exact consequence of an unlawful expropriation, as well as what constitutes "adequate" compensation, is subject to some controversy.

D.2 Fair and equitable treatment and full protection and security

Most IIAs will require the signatories to treat foreign investors fairly and equitably, and to provide full protection and security. For example, Article 2(2) of the UK-Lebanon BIT provides: "Investments of investors of each Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory the other Contracting Party."

Fair and Equitable Treatment (FET) is one of the most invoked treaty provisions. Its scope is not settled and will depend on the specific wording of the provision as well as the underlying facts. The *Rusoro v. Venezuela* tribunal outlined some of the common elements that may result in an FET breach:

> *The required threshold of propriety must be defined by the tribunal after a careful analysis of facts and circumstances, and taking into consideration a number of factors, including, among others, the following:*
>
> *- whether there has been harassment, coercion, abuse of power or other bad faith conduct by the host State;*
>
> *- whether the State had made specific representations to the investor, prior to the investment;*
>
> *- whether the State's actions or omissions can be labelled as arbitrary, discriminatory or inconsistent;*
>
> *- whether the State has respected the principles of due process and transparency when adopting the offending measures;*

- whether the State has failed to offer a stable and predictable legal framework, breaching the investor's legitimate expectations.[12]

As noted above, the application of these criteria depends on the facts and circumstances of a case, and because of the subjective nature of the terms used, this has led to considerable variance in the way FET has been interpreted. In general, an investor may be able to invoke the FET protection in circumstances where a state is seen to abuse its prerogative powers, as well as where there are sudden, unprovoked changes to a legal regime that may have been carried out with ulterior motives. It also protects against the denial of justice.

The Full Protection and Security (FPS) standard is intended to preserve the integrity of an investment. Like the FET clause, the scope of the FPS clause is subject to some controversy. While some tribunals have limited its scope to preserving the physical security of investments, others have gone further, stating that the scope of the clause may extend to legal security. At the very minimum, the FPS clause will generally ensure that a state respects the physical integrity of an investment.

D.3 No arbitrary or discriminatory treatment

Another commonly used provision is the prohibition of arbitrary (or unreasonable) or discriminatory treatment. For example, Article 2(2) of the UK-Lebanon BIT states: "Neither Contracting Party shall in any way impair by unreasonable or discriminate measures the management, maintenance, use, enjoyment or disposal of investments in territory of investors of the other Contracting Party." To determine whether an act was arbitrary, tribunals have typically followed the formulation by the International Court of Justice in the ELSI case: "Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law [. . .] It is a wilful disregard of

[12] *Rusoro Mining Ltd. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/12/5, Award (22 August 2016), paragraph 524.

due process of law, an act which shocks, or at least surprises, a sense of juridical propriety."

Discriminatory treatment involves treating like subjects in a dissimilar manner without reasonable justification. As explained by the tribunal in *Crystallex v. Venezuela*: "To show discrimination the investor must prove that it was subjected to different treatment in similar circumstances without reasonable justification."[13]

D.4 National treatment and most favored nation clause

IIAs often require host states to treat foreign investors at least as favorably as national investors via a provision that is often referred to as the "national treatment" clause. IIAs also often contain a provision stating that the investment of a foreign investor must be treated no less favorably than that of other foreign investors. Such clauses are known as most favored-nation (MFN) clauses. For example, Article 3 of the Czech Republic-Peru BIT states:

> *1. Each Contracting Party shall in its territory accord investment and returns of investors of the other Contracting Party treatment which is fair and equitable and not less favourable than that which it accords to investments and returns of its own investors or to investments and returns of investors of any third State whichever is more favourable.*
>
> *2. Each Contracting Party shall in its territory accord to investors of the other Contracting Party, as regards management, maintenance, use, enjoyment or disposal of their investment, treatment which is fair and equitable and not less favourable than that which it accords to its own investors or of any third State, whichever is more favourable.*

A national treatment clause requires an assessment of whether the foreign investor or investment was in a "similar situation" as national

[13] *Crystallex International Corporation v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/11/2, Award (4 April 2016), paragraph 616.

investors or investments. If so, the next step is to assess whether such treatment was less favorable, and further, whether the difference in treatment was justified.[14]

The application of the MFN clause, particularly to jurisdictional and procedural matters, has led to considerable debate and the jurisprudence is still not settled. In particular, MFN clauses have been used by investors to invoke more favorable procedural rights granted to investors from other states in order to avoid waiting periods, cooling-off periods, and other jurisdictional hurdles. The tribunals in *Maffezini v. Spain*,[15] *Siemens v. Argentina*,[16] and *Impregilo v. Argentina*[17] have ruled that an investor can use an MFN clause to invoke a more liberal dispute resolution provision found in another BIT. However, this approach was rejected in *Salini v. Jordan*,[18] *Plama v. Bulgaria*,[19] and *ICS v. Argentina*.[20] Although these differences might be explained because of differences in the languages of the MFN clause in different IIAs, this issue currently remains unresolved.

D.5 Umbrella clauses

Provisions whereby the host state commits to honor obligations that it has entered into *vis-à-vis* investors of another state are commonly referred to as "umbrella clauses." As an example, Article 3(1) of the Denmark-Peru BIT states: "Each Contracting Party shall observe any

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[14] *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, Award (27 August 2009), paragraph 399.
[15] *Emilio Agustín Maffezini v. Spain*, ICSID Case No ARB/97/7, Decision on Objections to Jurisdiction (25 January 2000).
[16] *Siemens AG v. Argentina*, ICSID Case No ARB/02/8, Decision on Jurisdiction (3 August 2004).
[17] *Impregilo S.p.A. v. Argentine Republic*, ICSID Case No. ARB/07/17, Award (21 June 2011), paragraphs 106-108 (majority).
[18] *Salini Costruttori SpA and Italstrade SpA v. Jordan*, ICSID Case No ARB/02/13, Decision on Jurisdiction (15 November 2004).
[19] *Plama Consortium Limited v. Bulgaria*, ICSID Case No ARB/03/24, Decision on Jurisdiction (8 February 2005).
[20] *ICS Inspection and Control Services Limited (United Kingdom) v. Argentine Republic*, PCA Case No. 2010-9, Award on Jurisdiction (10 February 2012), paragraph 301.

obligation it may have entered into with regard to investments of investors of the other Contracting Party."

Tribunals have not reached a consensus on the application of umbrella clauses to purely contractual matters. The tribunal in *SGS v. Pakistan*[21] found that in the absence of an intention to do so, the umbrella clause contained in the applicable BIT did not have the effect of elevating the contract claims to treaty claims. The tribunal in *SGS v. Philippines*,[22] on the other hand, held that such a clause could bring contractual commitments of the host state within the framework of the BIT.

E. What should you be doing?

IIAs provide foreign investors with substantive and valuable protections. As explained above, a careful review of IIAs will enable a sophisticated investor to assess protections potentially available and to ensure that it has the benefit of the most advantageous protections when making a foreign investment. In addition to allowing the investor to resolve any potential dispute in a neutral setting, such protections also add to the investor's leverage in the event of a dispute. Accordingly, it is advisable for investors, before they make their investment, to consider what protections might be available and to plan their treaty protection alongside any tax planning exercise. In particular, the following considerations are key:

[21] *Société Générale de Surveillance S.A. v. Pakistan*, ICSID Case No. ARB/01/13, Objections to Jurisdiction (6 August 2003). This approach was also followed by other tribunals. See, eg, *El Paso Energy International Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Decision on Jurisdiction (27 April 2006), paragraph 71.
[22] *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/ 02/6, Objections to Jurisdiction (29 January 2004). This approach was also followed by other tribunals. See, eg, *SGS Société Générale de Surveillance S.A. v. Republic of Paraguay*, ICSID Case No. ARB/07/29, Decision on Jurisdiction (12 February 2010), paragraphs 173-174; *Ioan Micula, Viorel Micula and others v. Romania*, ICSID Case No. ARB/05/20, Award (11 December 2013), paragraphs 417-418.

1. The investment structure, ie, the chain of ownership of a particular investment

2. Whether there is an applicable IIA between the host state and any of the home states of the companies in the investment structure (and, if not, whether investing through a different group entity might provide access to investment treaty protections)

3. The scope of application of each of the potentially relevant treaties, and in particular whether the definition of "investment" and "investor" under each of these treaties is fulfilled

For states, this means a careful review of the treaties that it is party to, including jurisdictional requirements to ensure that it is aware of the kind of investors that might be able to seek protection. They should also be familiar with the jurisprudence not only when negotiating and agreeing to new IIAs, but also when considering adopting measures that may implicate rights protected under existing IIAs.