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2nd Annual Forum of Developing Country Investment Negotiators

3 - 4 novembre 2008 - Marrakech - Maroc



**Report on the Second Annual Forum of Developing Country Investment Negotiators
Marrakech, Morocco, 2-4 November 2008**

This paper is provided as part of a series as background documents for the *2nd Annual Forum for Developing Country Investment Negotiators*, held in Marrakech, Morocco, 2-4 November 2008. The event was organized by the International Institute for Sustainable Development in partnership with the South Centre and the Moroccan Department of Investment. Support for the Forum has been generously provided by the Danish Ministry of Foreign Affairs, the International Development Research Centre and the Norwegian Agency for Development Corporation.

The **International Institute for Sustainable Development (IISD)** (www.iisd.org) is a Canadian-based not-for-profit organization. As a policy research institute dedicated to effective communication of our findings, we engage decision-makers in government, business, NGOs and other sectors in the development and implementation of policies that are simultaneously beneficial to the global economy, the environment and social well-being. IISD's work on investment seeks to promote investment as a means to achieve sustainable development. Our balanced and insightful approach is reflected in our widely circulated *Investment Treaty News bulletin*, and our solid expertise has persuaded tribunals in two cases (under ICSID and UNCITRAL) to grant us precedent-setting standing to intervene in investor-state disputes with broad public policy implications. We have been engaged to act as advisors to several developing countries in the course of their ongoing investment negotiations. Our work includes the drafting of a *Model Agreement on Investment for Sustainable Development*, which has won widespread critical acclaim.

The **South Centre** (www.southcentre.org) is an intergovernmental organization of developing countries established by the 1994 Intergovernmental Agreement to Establish the South Centre (deposited with the UN Secretary-General) which came into force on 31 July 1995. The South Centre currently has 50 developing country Member States. It has its headquarters in Geneva. The South Centre seeks to meet the need for analysis of development problems and experience, as well as to provide policy analysis and research support required by developing countries for collective and individual action, particularly in the international arena. The South Centre's primary objectives include the promotion of: developing country (South) solidarity and cooperation on development issues; South-wide collaboration in promoting common interests and coordinated participation by developing countries in international forums dealing with South-South and North-South matters, as well as with other global concerns; convergent views and approaches among countries of the South with respect to global economic, political and strategic issues related to evolving concepts of development, sovereignty and security; and better mutual understanding and cooperation between the South and the North on the basis of equity and justice. To meet its objectives, and within the limits of its capacity and mandate, the South Centre responds to requests for policy advice, and for technical and other support from collective entities of the South such as the Group of 77 and the Non-Aligned Movement. These functions are carried out by means of policy-oriented research and analysis, negotiations support and technical assistance, and capacity-building, and by publishing and disseminating widely the results of its work. The South Centre's main areas of policy expertise include trade, intellectual property, climate change, investment, finance, agriculture and services.

The **Department of Investment** has been in charge of promoting foreign investment in Morocco since 1996. Beyond its mandate to provide information on the country's potential, the Department creates and implements investment promotion strategies targeting specific sectors to promote the realization of projects. Its plan of action revolves around four main axes:

- Identifying different categories of investors and countries initiating foreign investment;
- Promoting priority sectors such as tourism, NTIC, electronic and automobile components, textiles, aeronautics and the agro-alimentary industry;
- Coordinating between national institutions and international organizations in the field of investment; and
- Locating projects according to the opportunities offered in the different regions of Morocco, in collaboration with the Regional Investment Centres.

In order to further the government's investment policy, while carrying out its mission, the Department of Investment is organized along two main poles, namely cross-sectional and sector-oriented:

- Two divisions cover investment promotion, communication and cooperation, research and regulations;
- Two other divisions are dedicated to activities in priority sectors, agriculture and industry on one hand, tourism and services on the other.

To maximize efficiency, these structures benefit from the support of offices in charge of human resources and general affairs. The Department of Investment, along with its initial mandate, also steers the Inter-Ministerial Investment Commission, an appeal and arbitration body presided by the Prime Minister. The Department of Investment plans to establish an independent agency dealing specifically with promotion in early 2009.

Report on the Second Annual Forum of Developing Country Investment Negotiators Marrakech, Morocco, 2-4 November 2008

Introduction

On 2-4 November 2008 the Second Annual Forum of Developing Country Investment Negotiators was held in Marrakech, Morocco. Participants at the second annual negotiators' forum included 49 government investment negotiators from more than 35 developing countries with a wide geographic distribution. The forum was organized by IISD, the South Centre and the Moroccan Department of Investment and followed on from the first annual forum of developing country investment negotiators, held in Singapore in October 2007.

Discussants at the forum included representatives of developing country governments sharing firsthand experiences of the potential pitfalls in investment treaties and investment arbitrations; representatives of regional organizations negotiating development-minded international investment agreements; law professors specializing in international investment law; and experts from the South Centre and IISD.

The forum opened with a thought-provoking address by Mr. Makhdoom Ali Khan, the former Attorney-General of Pakistan who described his country's experience when faced with its first investment treaty arbitration. He said that, like many countries, Pakistan had signed bilateral investment treaties (BITs) because it was fashionable to do so and under the impression that BITs would not "bite". He noted that this impression had since been dispelled by the various high-value investor claims that Pakistan has faced, several of which sought more than Pakistan's annual health and education budget combined. He described the difficulty for a host state in mounting a defence to an investor's claim when it has little expertise in the area and government record-keeping of treaty negotiations and of investor communications is poor. Although he did not discount that arbitration can be a useful tool, he expressed concern with the current way in which three private lawyers sitting as the arbitral tribunal have more power than the host state's highest court. He also expressed concern about the intrusive powers that tribunals have to access government files.

The forum had six sessions, each opening with speakers with experiences to share in that area followed by questions and comments by participants. Topics discussed included:

- I. Recent developments in investment negotiations in bilateral, regional and multilateral treaty instruments
- II. Negotiating IIAs – Importance of defining terms and concepts; State of the art on key terms
- III. Negotiating IIAs - Advances in investor-state arbitration and the debate on transparency in the investor-state arbitration
- IV. Negotiating IIAs - Defining investor obligations and ensuring development policy space for host countries
- V. Linkages between international investment treaties and investment contracts
- VI. Climate change and IIAs

A number of up-to-the-minute background papers were prepared for the forum and these, together with the forum agenda, are available at http://www.iisd.org/investment/capacity/dci_forum_2008.asp
A summary of the main points discussed during the forum is set out below.

Session I. Recent developments in investment negotiations in bilateral, regional and multilateral treaty instruments

i. Developments at the bilateral level

At the end of 2007, the total stock of BITs in the world was 2608 and involved 179 countries. (These are signed treaties, not all are ratified.) The total number of BITs in the world continues to grow; however, the last few years have shown that this is taking place at a much slower rate than before. Seven out of the top ten signatories of BITs are European countries. China and the Republic of Korea are also in the top ten.

Over the last few years, the number of BITs between developing countries has grown, now representing more than 26% of the total number of BITs. This may in part reflect the stronger role of some developing countries as capital exporters. For example, China now has the second largest number of BITs in the world.

Some IIAs signed by developing countries have shown innovative trends. For example, the investment chapter in the India-Singapore Comprehensive Economic Cooperation Agreement does not include provisions for “most favoured nation”, “fair and equitable treatment” or “full protection and security” – notable omissions at a time when an increasing number of investment treaty disputes are hinging on the host state’s duty to provide fair and equitable treatment.

2007 showed interesting differences across regions in the conclusion of BITs. Asian countries are the most active by their conclusion of 29 of the total of 44 new BITs last year. In 2007, countries in South-East Europe and the Commonwealth of Independent States signed 11 of the new BITs and were involved in 22 per cent of all BITs. In 2007, African countries concluded 11 new BITs and were party to 27 per cent of all BITs.

In contrast, Latin American and Caribbean countries were the least active in concluding BITs, with only four new BITs in 2007, none in the first half of 2008, and dropping to 19 per cent of all BITs by the end of 2007. Colombia, Peru and Chile continue to have an active agenda in negotiations while Argentina, Bolivia, Ecuador and Venezuela were rethinking the utility of IIAs for attracting investment. In 2007, Bolivia declared its withdrawal from the International Centre for Settlement of Investment Disputes (ICSID), and was reported reviewing the termination of its existing BITs. Ecuador also announced that its consent to ICSID arbitration was no longer available for any disputes arising from mining and oil contracts and that it would denounce at least 9 of its 25 BITs which it considers as not having brought any noticeable benefits to its economy. Venezuela also made public similar concerns but has not issued a formal withdrawal from ICSID as yet. It reportedly denounced its BIT with the Netherlands in April 2008. One of the factors responsible for the decline in the Latin American appetite for BITs could be the fact that countries in the region have been the respondents in a large number of investor-state disputes arising under BITs.

In 2007, 10 of the 44 new BITs replaced earlier treaties. Compared to the total number of existing BITs (2,608), the share of renegotiated agreements, (121 at the end of 2007), is minor – less than 5 percent. However, this number is expected to rise, since a growing number of BITs are nearing the expiry of their initial period of validity.

According to UNCTAD, the total cumulative number of known investor state arbitrations reached 290 in 2007, although other estimates indicate that this number has crossed 300. At least 73 governments – 44 of them in the developing world, 15 in developed countries and 14 in South-Eastern Europe and the Commonwealth of Independent States – have faced investment treaty arbitration.

The increasing use of BITs by investors, and the interpretations of often broadly drafted investment protection obligations, appear to have prompted the conclusion of BITs based on newer models which feature host state development considerations, absent from the vast majority of BITs. A trend among developing countries may be a greater questioning- and at times even a rejection- of existing BIT models. For example, South Africa and Pakistan both refused to sign BITs based on the US Model.

ii. *Developments at the regional level*

The slowdown in the rate at which the countries have signed BITs over the last few years is contrasted by the surge in free trade agreements and other treaties on economic cooperation containing investment provisions. As at the end of 2007, the total number of such treaties was 259. While the total number of such agreements is still small compared to the number of BITs, they have almost doubled during the past five years. As in the case of BITs, most of the treaty-making activity in 2007 involved Asian countries. Treaties that combine trade and investment liberalization appear to be increasing. What is less clear is whether the scope of liberalization is increasing significantly under these agreements.

The trend towards regional investment treaties particularly among African countries appears to have strengthened in the last couple of years. For example, 2007 saw the conclusion of the COMESA Investment Agreement (CCIA) and the SADC Finance and Investment Protocol (FIP).

Investment has also been an issue in the Economic Partnership Agreement (EPA) negotiations between the African, Pacific and Caribbean (ACP) countries and the European Union (EU). The EPA negotiations commenced in 2002 pursuant to the Cotonou Agreement between ACP countries and the EU with the objective of delivering trade agreements by 31 December 2007. To date, the only “full” EPA is the CARIFORUM-EC EPA signed in October 2008. 2008 is expected to lead to an intensification of EPA negotiations with the remaining ACP countries. The European Commission (EC) is pushing for investment, competition and public procurement to be included in the EPAs. Developing countries had previously provided a stiff opposition to these issues in the WTO.

iii. *Developments at the multilateral level*

WTO Members considered the establishment of a multilateral investment agreement in the initial stages of the Doha Development Agenda (DDA). However, no consensus on launching negotiations in this area was reached and the topic was removed from the DDA’s work programme as part of the July 2004 General Council Decision.

The General Agreement on Trade in Services (GATS) can be described as a multilateral agreement that covers investment in the services trade context, however it is not an agreement on investment in the spirit of the failed Multilateral Agreement on Investment. According to the GATS classification, international trade in services occurs through four different modes: cross-border supply (mode 1); consumption abroad (mode 2); commercial presence (mode 3); and movement of natural persons (mode 4). “Commercial presence” (mode 3) covers foreign direct investment in services where the

investor of another member state holds more than 50 per cent of the equity interest or exercises control over the invested enterprise.

Each WTO member makes commitments – set out in a schedule – in service sectors ranging from transport and communication services to health, education and tourism services across the four modes of service supply. Commercial presence is the area where the largest number of liberalization commitments has been undertaken by WTO members. Commitments are made in relation to “market access” and “national treatment”.

A full commitment on “market access” would prohibit a country from limiting access to its services markets and grant full access to foreign investors. However, a country need not make a full commitment to “market access” and WTO members can determine individually the limitations, conditions and terms of “market access” that fall short of full market access. Such limitations, conditions and terms must be applied without discrimination to the services and service suppliers of all WTO members. The six permitted limitations are: limitations on the number of service suppliers; limitations on the total number of natural persons that may be employed in a particular service or that a service supplier may employ; limitations on the total value of service transactions or assets; limitations on the total number of service operations or on the total quantity of service output; measures that restrict or require specific types of legal entity or joint venture; and limitations on the participation of foreign capital.

A full commitment on “national treatment” prohibits a State from discriminating between domestic and foreign “like” services and service suppliers. In determining what constitutes discrimination of like services and service suppliers, much depends on the interpretation of “like”. The GATS affords no automatic right of establishment to foreign investors. The only obligations of WTO members are to schedule any existing restrictive measure they wish to maintain in sectors where liberalization commitments are voluntarily undertaken and to ensure freedom of payments and transfers relating to investments in such sectors.

Market access commitments are particularly important. If a country “A” commits to open a sector e.g. insurance sector to foreign providers, it cannot change its mind without compensating those countries whose trade in services is harmed by this change, i.e. through liberalizing equivalent service sectors in exchange, or, as a last resort, the country whose providers are affected could withdraw equivalent market access from country A’s providers.

Governments can use the GATS selectively to encourage investment in sectors of their choice, subject to the conditions they wish to impose or retain, including with respect to technology transfers and the employment or training of local workers. The Agreement also permits governments to maintain foreign ownership restrictions in sectors where they have made commitments.

Members of the WTO have agreed that a central task in the ongoing set of services negotiations will be to further develop rules to ensure that domestic regulations support rather than impede the opening of services markets to trade. Policy-makers should therefore be attuned to the negotiations surrounding the development of GATS rules.

Session II. Negotiating IIAs – Importance of defining terms and concepts; State of the art on key terms

States faced with investor-state arbitrations have often found that the definition of investment in their IIAs is far broader than that in their domestic laws and regulations. What constitutes an investment is critical as it is a threshold jurisdictional question in any IIA arbitration.

If the arbitration is under the ICSID Convention, the investor will need to persuade the tribunal that its claim meets the definition of investment under both the applicable IIA and Article 25 of the ICSID Convention.

i. Definition of investment under IIAs

Virtually all IIAs define investment. Nearly all of the definitions begin with a wide, open-ended phrase, stating that investment means “every kind of asset” or “any kind of asset” followed by an illustrative list of approximately five or six categories of assets, interest and rights.

Such a broad and general definition can make it difficult for host state governments to predict which investments come under the protection of the treaty. There appears to be a growing recognition that the definition of investment should therefore be drafted with greater precision. For example, the Investment Agreement for the COMESA Common Investment Area (CCIA) attempts to limit the expansive coverage of assets ordinarily found in the definition of investment in BITs. The CCIA definition also limits the coverage of intellectual property rights to those associated with a business operating in the host state territory. The CCIA investment definition also contains an important list of what is expressly excluded from the definition of investment.

Greater clarity and precision in drafting IIAs’ definition of investment would limit the element of surprise for host states resulting from the wide interpretation to what tribunals find to qualify as an investment.

ii. Definition of investment under the ICSID Convention

The majority of known investment treaty arbitrations are filed at ICSID. Article 25 of the ICSID Convention limits the Centre’s jurisdiction to legal disputes arising “directly out of an investment”. As the term “investment” is not defined in the ICSID Convention, the matter is left for tribunals to interpret. Cases to date have revealed a diverse range of assets to have satisfied the test of disputes “arising directly out of an investment” under the ICSID Convention.

Governments negotiating IIAs should be aware that it is possible that an asset or interest may be within the definition of investment under the IIA but not satisfy article 25 of the ICSID Convention. In deciding whether an investment meets the definition of the ICSID Convention, a number of tribunals have held that “the basic features of an investment have been described as involving a certain duration, a certain regularity of profit and return, assumption of risk, a substantial commitment and a significance for the host state’s development”.

Whilst in an ICSID arbitration, the definitional threshold must be met under both the IIA and the ICSID Convention, non-ICSID arbitrations only require the test in the IIA to be met.

iii. Investment according to law

The definition of investment in a large number of IIAs includes a requirement that the investment must be made in accordance with the laws and the regulations of the host state. This phrase prevents investments that would be illegal under the host state law from receiving protection under the treaty. However, tribunals have rejected host state arguments that this provision requires that the subject asset

or interest must meet the requirements of an investment under the host state's domestic law i.e. the provision refers to the legality of the investment, not to its definition.

iv. Indirect Investment

Foreign investors often make their investments through subsidiary companies incorporated in the host state. Without a specific agreement to the contrary, a locally incorporated subsidiary will not be able to bring a treaty claim against the host state. However, as most treaties explicitly include shares, stocks or any interest in a company in the definition of investments, a foreign shareholder in the subsidiary can generally bring a claim under an applicable treaty for damages with respect to its shareholdings. It is not essential that the shareholder's stake in the subsidiary be a controlling interest, even a minority stake would qualify. Tribunals have yet to rule on the question of whether portfolio investors (investors who hold shares only as an investment and not for management purposes) are covered but it seems possible that they would be. With this in mind, the CCIA explicitly excludes portfolio investment from its definition of investment.

v. Approval of investments

A number of treaties, particularly those concluded by centrally planned economies, contain a requirement that the investment must be registered and approved in writing to qualify for protection under the treaty. As economies have grown more liberal, the requirements to register investments or to obtain formal approval have waned in popularity in recent BITs. However, such a provision appears to have seen a recent revival in some agreements, such as the CCIA which restricts the benefit of the agreement to investments that are duly registered under the agreement. Rather than the traditional rationale used by centrally planned economies, the CCIA approach appears aimed at creating a mechanism that assists host states in identifying the investments that are affected by their measures.

vi. National of the other Contracting Party

In a number of cases, host states have challenged a claimant company's right to bring a claim under the relevant IIA on the ground that the company was really only a shell with no real business in the home state and so should not be entitled to be treated as a national of the other contracting party for the purpose of the IIA. A number of tribunals have rejected this argument, holding that unless there is some specific requirements in the IIA on this point, they can only go by the wording of the IIA (which generally just refer to "a national of the other contracting party"). Some IIAs, however, have taken steps to avoid the possibility of investors using corporate shells to treaty-shop. For example, the India-Singapore Comprehensive Economic Cooperation Agreement excludes any legal entity with negligible or no business operations or with no real and continuous business activities carried out in the territory of the other Party from being considered an investor under the treaty.

vii. Expropriation and host states' right to regulate

The issue, in a nutshell, is whether bona fide regulatory measures such as those to protect the environment, human health or safety are to be considered as expropriations and thus requiring compensation under the IIA's expropriation clause. The existing arbitral decisions go in two separate and irreconcilable directions. Some say the key element is the economic impact of the measure, irrespective of its motivation (e.g. *Metalclad v. United States*, *TECMED v. Mexico*). Others say that genuine regulatory measures fall within the customary international law concept of "police powers" and do not constitute expropriatory measures (*Methanex v. United States*). Recent IIA awards have not provided any additional clarity for states on whether regulatory measures taken by them that impact the economics of an investment will be deemed an expropriation.

This issue has been addressed in several recent IIAs. The Norwegian model IIA provides that its expropriation clause shall not in any way impair the right of a Party to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties. It also departs from the usual requirement that compensation shall be paid in connection with expropriation.

The CARIFORUM-EU EPA states that the Parties and the Signatory CARIFORUM States retain the right to regulate and to introduce new regulations to meet legitimate policy objectives.

Article 20(8) of the CCIA provides that: “Consistent with the right of states to regulate and the customary international law principles on police powers, bona fide regulatory measures taken by a Member State that are designed and applied to protect or enhance legitimate public welfare objectives, such as public health, safety and the environment, shall not constitute an indirect expropriation under this Article.” The CCIA also provides that its expropriation provision shall not apply to the issuance of compulsory licenses granted in relation to intellectual property rights. Under the CCIA compensation may be adjusted to reflect the aggravating conduct by a COMESA investor or a failure to mitigate damages. Article 22 of the CCIA also contains a detailed list of exceptions for measures taken by a state to protect public interest and security. Articles 24 and 25 of the CCIA allow a member state to take safeguard measures in emergency situations and serious balance of payments or external financial difficulties.

Several recent IIAs contain a weaker version of this clause, e.g. “except in rare circumstances” non discriminatory measures designed to protect legitimate public welfare objectives shall not constitute an expropriation. While arguably an improvement of the status quo, they introduce uncertainty as to which cases qualify as “rare circumstances”.

Furthermore, at least one recently signed IIA specifies a precise list of types of measures that will not constitute an indirect expropriation, eg a measure necessary to protect human, animal or plant life or health. The difficulties with this approach means that a) it establishes a high threshold (e.g. “necessary”) and b) it creates a narrow band of express exceptions which by implication prevent other types of public welfare measures from qualifying as exceptions to expropriations.

viii. Most favoured nation treatment

It is important for host states to remember that even if host states carefully protect policy space in all future IIAs, if they are party to just one IIA which does not provide such protection, investors can rely on the MFN clauses in the IIAs to circumvent its worthy objectives.

Session III. Negotiating IIAs - Advances in investor-state arbitration and the debate on transparency

i. Developments in the rules for investment arbitration

In the last three years, the three most commonly used sets of rules, the ICSID Arbitration Rules (used in 62% known arbitrations), the UNCITRAL Arbitration Rules (28% known arbitrations) and the Arbitration Rules of the Stockholm Chamber of Commerce (5% known arbitrations) have all been revised or are being revised at present.

The above figures for the UNCITRAL and the Stockholm Chamber of Commerce may well underestimate the true number of arbitrations due to the secrecy in which such arbitrations are conducted. There is nowhere one can go to find out which cases exist under these rules, who they were brought by and what they are about. Importantly from the perspective of host states, this includes even the home state of the investor - the other contracting party to the treaty. The tribunal will interpret its own treaty but it does not have a right to know that the case exists, what it is about and the opportunity to say how it believes the treaty was intended to be interpreted. It may not even learn the outcome unless one of the disputing parties chooses to make it available.

a. *ICSID Rules*

The latest round of amendments to the ICSID Rules and Regulations entered into effect on April 2006, following growing criticism from civil society groups and others at the lack of transparency or possibility for the public to be heard in cases that may affect them. Unless the host state and the investor expressly agree otherwise, these amendments will apply to all future ICSID arbitrations. On the whole, the ICSID amendments are favourable to host states. They add an expedited procedure for host states to make a preliminary objection that an investor's claim is without merit. The contents of arbitrators' declarations of independence are somewhat expanded, although still only to be made once the tribunal is appointed. If a tribunal wishes for a higher fee than the daily rate set by ICSID it must now make its request through the Secretary-General. A rather token change is that the tribunal, after consultation with the ICSID Secretary-General, may allow observers to attend all or part of the hearings, "unless either party objects". Previously, the parties had to give their consent. A more substantial advance is the explicit inclusion of a power, up to now implicit, for tribunals to allow a non-disputing party to file a written submission regarding a matter within the scope of the dispute. Although the ICSID secretariat can still only publish the full award with the consent of both parties, the ICSID is now required to publish excerpts of the tribunal's legal reasoning.

b. *Rules of the Stockholm Chamber of Commerce*

The new arbitration rules of the Stockholm Chamber of Commerce (SCC) were approved by its Board in November 2006 and apply to all cases filed after 1 January 2007. Some of the revisions to the SCC Rules are beneficial for host states, others are not so positive. There is now an express requirement for arbitrators to complete a written form confirming their impartiality and independence, albeit like ICSID only after their appointment. The rules also introduce a new ground upon which to challenge an arbitrator during an arbitral proceeding, namely that the arbitrator lacks qualifications agreed by the parties. On the less positive side, the investor may now request the arbitral tribunal to order the host state to reimburse the investor for paying more than its half of the advance on costs, removing the possibility of a host state avoiding arbitration by not paying its share of the advance on costs. There is also a new potentially intrusive provision empowering the tribunal to, at the request of a party, order the other party to produce any evidence or documents that may be relevant to the outcome of the case.

c. *UNCITRAL Arbitration Rules*

In 2006, the United Nations Commission on International Trade Law (UNCITRAL) agreed that its Working Group II (Arbitration and Conciliation) should undertake a revision of the UNCITRAL Arbitration Rules. This is the first time that the rules are to be revised since the rules were adopted in 1976. The Working Group is currently midway through its second reading of the draft revised rules. The Commission has expressed the hope the final review and adoption of the revised Rules can take place at its next session in June 2009.

At the Commission's session in June 2008, the Commission agreed that the topic of transparency in treaty-based investor-State arbitration was worthy of future consideration and should be dealt with as a matter of priority immediately after completion of the current revision of the UNCITRAL Arbitration Rules.

As with the SCC Rules, some of the changes to the UNCITRAL Rules discussed to date are mildly beneficial for host states, however some are more concerning. On the positive side are provisions designed to limit arbitration costs to what is "reasonable" and to require tribunals to inform the parties of their costs methodology and calculations. The obligation on arbitrators to disclose any circumstances likely to give rise to justifiable doubts as to their impartiality is now a continuing one and the procedure for challenging an arbitrator has been refined. The scope for potential counter-claims or set-offs may be extended to either those arising out of the same legal relationship or those falling within the scope of the arbitration agreement. Currently, an UNCITRAL award may be made public only with the consent of both parties. The proposed revised rule will also allow disclosure where required under a legal duty or to protect or pursue a legal right.

Of greater concern, the revised rules add a requirement that parties waive their right to any form of appeal. They also add a new provision that will exclude liability of arbitrators and other participants in the arbitral process for any act or omission in connection with the arbitration to the fullest extent permitted under the applicable law.

To add a point of confusion, the new rules do not make clear whether a BIT which refers to the "UNCITRAL Rules" without specifying which version will be presumed to refer to the original rules or the revised rules once adopted.

It should be noted that all arbitration rules are always subject to express provisions in the treaties themselves. Thus, states are free in their treaties to include express clauses that will replace any offending provisions in the arbitration rules.

ii. Developments in IIA dispute settlement provisions

Perhaps the most significant recent development in the dispute settlement provisions of investment treaties has been the introduction of clauses designed to improve transparency and the consideration of the public interest aspects of the investor-state arbitration process. This began with statements of interpretation issued by parties to the NAFTA in 2001 and 2003 on access to documents, the possibility for written submissions from non-disputing parties and later, on open hearings. Provisions similar to the NAFTA statements are now part of the model BITs of Canada, the United States and most recently Norway and have been incorporated in a number of recent US and Canadian BITs with developing countries. The most advanced provisions, however, are found in the CCA, not yet in force. Notably, it extends the requirements for transparency and public access to proceedings to disputes between Member States as well as between a Member State and an investor.

In addition to the provisions of transparency, the CCA also aims to prevent investors having "two bites of the same cherry" by bringing similar claims against a host state in several different fora. The agreement requires an investor to make a definitive election of forum and it may not thereafter submit a claim relating to the same subject matter or underlying measure to other fora. The CCA also entitles a

Member State facing an investor claim to assert as a defence, counterclaim or set-off, that the investor has not fulfilled its obligations under the treaty.

In a number of cases, tribunals have said that greater transparency and the possibility for submissions from non-disputing parties, enhance its decision-making and in the wider context, the legitimacy of the investor-state arbitration process itself. However, the confidentiality orders recently issued in several cases against the wishes of the host states, eg *Biwater Gauff v. Tanzania* and *Chemtura Corporation v. Canada*, shows that unless transparency provisions are enshrined in the treaty itself they may be overruled. Such cases illustrate the need for provisions on transparency to be included in the investment treaty itself in language that is not voidable at the option of one of the disputing parties.

Session IV. Negotiating IIAs - Defining investor obligations and ensuring development policy space for host countries

In recent years arbitral tribunals have shown growing recognition that investors have certain basic obligations and that host states should be entitled to policy space to pursue their development needs. While such recognition is welcome, it is far from cast in stone. The lack of a doctrine of precedent in international arbitration means that future tribunals are not bound by the decisions of other tribunals. Thus, although the views of past tribunals may provide some guidance as to how future tribunals may approach the issues, the only way to *ensure* that investors are held to their obligations and host states' right to policy space is respected, is through express provisions in the investment treaties.

i. Tribunal recognition of investor obligations

On the basis of arbitral awards to date, investors can be considered to have three main obligations. First, the investor is bound not to engage in unconscionable conduct, including corruption, fraud, misrepresentation, undue influence or abuse of power. The investor should also be transparent in its dealings with the host state. In recent years, tribunals have become more willing to examine allegations of corruption by one or other party. Unconscionable conduct may vitiate the investor's claim in its entirety, on the basis that such conduct is against the "international public order".

Second, the investor is required to make a reasonable risk assessment prior to investing in the host state. Investment treaties are not insurance policies for bad business judgments. The investor must undertake a proper feasibility study and bear the risk of choosing to invest in a high risk location.

Third, the investor is bound to manage and operate the investment in a reasonable manner. Loss suffered due to bad management should not be recovered from host state. The investor must manage in a way that will ensure the economic viability of the investment. It must be aware of the regulatory environment in which it operates and foresee regulatory changes likely in that environment. It must comply with host state regulatory requirements, take relevant professional advice and bear the risk of obtaining bad advice.

The effect of a breach of one of the above obligations differs depending on the obligation. If the tribunal finds that the investor has engaged in unconscionable conduct, its claim may be vitiated. By contrast, breaches of the other two obligations may lead to a reduction of compensation in proportion to the degree of the investor's loss that can be attributed to its own conduct as opposed to the host state's treaty breaches.

ii. Tribunal recognition of host state policy space

Policy space is the term often used to denote the space left to governments to govern and regulate as they see fit while still observing their obligations under international and national law. Investment treaties have the potential to restrict policy space because the investor may use treaty protections to challenge a host state's legally valid regulations and policies.

In several recent awards, tribunals have expressly noted the importance of host states' need for policy space and interpreted treaty obligations to allow for public welfare considerations. For example, with respect to fair and equitable treatment, most favoured nation, national treatment and other treaty standards for which discriminatory conduct by the host state can amount to a breach, the tribunal in *Methanex v. United States* criticized the traditional trade law approach of determining whether an investor and another enterprise are in like circumstances by virtue of whether the two enterprises are in competition. It said that the best comparison available should be used, and particularly enterprises in identical circumstances where these are available. In the *Parkerings v. Lithuania* case, the tribunal held that public policy considerations can differentiate enterprises for the purposes of deciding whether they are in like circumstances.

In respect of expropriation, three different approaches are discernible in the cases. On the first approach, coined in the *Metalclad v. Mexico* case, the tribunal should not consider the purpose of the challenged host state measure but merely its effect on the investor. On the second approach, used in the *Tecmed v. Mexico* case, a public policy measure may be exempted from compensation but only if the burden on the investor is proportion and not an individual or excessive burden. The third approach, summarized in the *Methanex* case, posits that a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process is not expropriatory and compensable unless specific commitments have been given by the host state to the investor contemplating investment that the government would refrain from such regulation.

Even on the most progressive *Methanex* approach, subsequent tribunals have noted that the dividing line between when a measure falls within police/regulatory powers or not is not clear.

Moreover, the lack of a doctrine of precedent in international arbitration means that there is no guarantee that future tribunals will follow the more progressive approaches. In sum, the only way to ensure that investors are held to the obligations outlined above and that host state policy space is protected is by including express provisions on these points in the treaty.

iii. Imposing investor obligations and protecting policy space in IIAs

The prevailing approach in IIAs to date regarding policy space and regulatory flexibility is to treat them as exceptions to the general rule of investment protection and promotion. For example, countries use reservations, exceptions, temporary derogations, transitional arrangements, and institutionalized monitoring and consultations mechanisms to indirectly address development and policy space concerns in their IIAs. Under this approach, the general rule of investment protection is interpreted broadly whilst exceptions for policy space are interpreted narrowly.

In contrast, a growing number of countries are using alternative approaches in the aim of protecting policy space and regulatory flexibility. First, by clarifying individual IIA provisions where there was

concern that an expansive interpretation could diminish regulatory flexibility of host countries e.g. what constitutes fair and equitable treatment and indirect expropriation. Second, by emphasizing public policy concerns to ensure that investment protection is not pursued at the expense of other legitimate public interests, e.g. “police power” exceptions for host country measures to protect public health, safety or the environment or provisions calling upon host countries not to depart from labour or environmental standards in attracting foreign investment (though the latter often impose no binding obligation). Third, by providing for greater public transparency in investor-State dispute resolution e.g. through open hearings, publication of pleadings and tribunal decisions and provision for civil society representatives to submit amicus curiae briefs to tribunals.

In respect of investor and home country obligations, express provisions on these can now be found in a small number of IIAs. Examples of this approach are found in the 1998 Framework Agreement for ASEAN Investment Area (soon to be replaced by ASEAN Common Investment Area), the Agreement for the COMESA Common Investment Area and the European Union-CARIFORUM Economic Partnership Agreement.

Session V. Linkages between international investment treaties and investment contracts

Investors may benefit from the protection of an investment treaty without having a contract with the host state. However, the existence of a contract may increase and colour the host states’ obligations under the investment treaty.

It is important to understand the potential linkages between investment treaties and contracts between investors and host governments. Treaties can be used to enforce contracts and override choice of law clause in contracts. Moreover, even the most favourable arbitral decisions on host states’ right to regulate to date have held that this right is reversible in the face of a stabilisation clause in the investment contract.

Investors can claim that a breach of an investment contract is a breach of an investment treaty in three ways. First, investors have argued that a breach of a contract can also, independently, be a breach of a treaty provision. This simply requires restating the breach of contract claim as a breach of a guarantee on, for example, fair and equitable treatment. This approach has been approved in several arbitration cases to date, even when the contract has included a specific alternative dispute settlement process. Second, a growing number of cases have seen the interpretation or application of treaty provisions being shaped by the presence or absence of different types of contract provisions. For example, it was noted in *Methanex v. United States* that if the host government has given specific commitments to the investor prior to investing that the government would refrain from such regulation, e.g. through a stabilisation clause in an investment contract, a non-discriminatory regulation for a public purpose otherwise deemed as not expropriatory may become so. Similarly, following *Parkerings v. Lithuania*, a stabilization clause in an investment contract may be relevant to the interpretation or application of a fair and equitable treatment standard in the treaty as the clause may give rise to a reasonable expectation on the part of the investor that its investment will not be affected by regulatory change.

Third, there is the use of an “umbrella” clause in the treaty. An umbrella clause is a provision obliging the host state to observe all undertakings or commitments it makes to the investor. Tribunals have

interpreted such clauses in very different ways. Some tribunals have said that an umbrella clause converts all contractual, legislative or other commitments of the host state to obligations enforceable under the treaty. Other tribunals have taken narrower approaches, e.g. limiting the effect of the umbrella clause to commitments made in the state's sovereign capacity, such as stabilisation clauses. Whichever of these approaches is taken, however, an umbrella clause has the effect of converting certain contractual obligations into obligations under the treaty.

The lack of consistency in tribunal interpretations of umbrella clauses and their potentially expansive consequences means that host states negotiating investment treaties should think carefully about what obligation they are willing to assume and word the clause carefully to reflect this, or alternatively, omit the clause altogether.

Investors often use multiple legal approaches in respect of their disputes with host states. For example, they may bring a contract claim to arbitration or the host state courts and a treaty claim to arbitration at the same time. Tribunals hearing a treaty claim are not bound to follow or respect the outcome of national court decisions or arbitrations under the investment contract. Furthermore, host state court decisions are subject to review by the tribunal when deciding whether the host state has met its treaty obligations.

Because of the importance of investment contracts, both in terms of the contractual obligations imposed on host states, and the effect of those obligations on the host state's treaty obligations, it is important to have skilled negotiators involved in the negotiation of investment contracts who are aware of the contract's possible treaty implications.

Recent research into stabilization clauses in investment contracts has found that stabilization clauses are still drafted in ways that allow investors to avoid environmental and social regulation in the host state. This is particularly so in non-OECD host states. The research identified three types of stabilization clauses: "freezing clauses" which freeze the law of the host state with respect to the investment over the life of the project; "economic equilibrium clauses" which require the investor to comply with new laws, but to be compensated by the host state for the cost of compliance; and "hybrid clauses" which share some aspects of both and which require the state to restore the investor to the same position it had prior to changes in the law. It found that stabilization clauses contained in investment contracts with OECD host states were significantly less onerous than those found in contracts with non-OECD host states.

If it is necessary to include stabilization clauses in investment contracts, they could be limited to a few political factors, excluding environmental and social regulations from their scope. There is a problem of negotiating capacity for developing country host states in comparison to investors' negotiators. Host states frequently underestimate the value of their own assets. Moreover, because large multinational corporations frequently retain several large law firms, it can become difficult, sometimes impossible, for host states to find legal representation by lawyers experienced in international investment arbitration.

Session VI. Climate change and IIAs

i. Potential obstacles for host states

There is a need for climate-related investment. 2.4 billion people are still using traditional biomass to supply their energy needs, with associated health affects, particularly for women and children, and 1.6 billion people have no access to grid electricity. The International Energy Agency estimates that there needs \$27 trillion in incremental investment in developing countries by 2050 to reach the targets of the International Panel on Climate Change.

Policies that might be used to promote investment to address climate change include the regulation of existing facilities; closure or significant retrofit of high energy-use facilities; discrimination in favour of clean new technologies; and adaptation-related policies such as water rationing and reallocation and energy access requirements.

However, these policies may potentially conflict with the standard investor protection provisions in IIAs. For example, if the regulation has significant impacts on the investor, it will depend on whether an arbitral tribunal uses the “sole effects” doctrine or police powers carve out approach as its legal test for an expropriation. If the underlying investment contract contains a stabilization clause, the regulation may be seen both as a breach of contract and the IIA.

Regarding policies of discriminating in favour of clean energy, if host states’ IIAs include pre-establishment rights, then national treatment will be required. Following recent tribunal awards, it is now probable that host states can discriminate between clean and dirty energy providers as not “in like circumstances”, however this is not certain. It may also be possible for host states to discriminate between different types of clean energy providers (e.g., solar vs. wind) but this is even less certain.

In respect of climate change adaptation policies, these might also be challenged under IIAs. For example, water rationing or reallocation could potentially be challenged by investors as an expropriation or a breach of fair and equitable treatment and energy access requirements could be challenged under IIAs prohibiting the imposition of permanence requirements.

IIAs thus have the potential to restrict some of the policies governments might want to take. However, with proper foresight and knowledge, conflict is not necessary. When negotiating IIAs, it is important to draft them so as to allow host states to meet their climate change needs.

ii. Potential opportunities for host states

Climate change may create investment opportunities for developing countries, for example investment in clean energy projects (wind, solar energy), timberland, reforestation, and clean development mechanism projects.

The Kyoto Protocol, established under the United Nations Framework Convention on Climate Change 1992, entered force in February 2005. It places obligations on industrialised countries to reduce greenhouse gas emissions as per agreed targets between 2008 - 2012 (Annex 1 countries). There are no reduction targets for developing (non-Annex 1) countries. Article 12 of the Protocol defines clean development mechanisms (CDMs). CDMs can be used to leverage foreign investment for sustainable development into developing countries.

To qualify as a CDM, a project must be located in a Non-Annex 1 Developing Country which has acceded to the Kyoto Protocol, must lead to long term emissions reduction, must assist in achieving sustainable development, must lead to technology transfer and have additionality (i.e. not a business-as-usual

project). If these criteria are met, the CDM will result in tradable Certified Emissions Reductions or Carbon Credits. To host CDM projects, a country must set up Designated National Authority (DNA) which certifies that projects meet the CDM requirements. Each country can determine its own criteria for sustainable development. For example, South Africa has four main criteria: economic development, social development, environmental compliance, general project acceptability (equality of distribution of project benefits). To date, Africa has disproportionately few CDMs compared with other developing regions and there is a need for capacity building and training.

Government investment negotiators should coordinate with their government's climate change negotiators to ensure that IIAs and investment laws are drafted so to provide opportunities and not obstacles to furthering climate change objectives, and vice versa that climate change policy provides opportunities and not obstacles to foreign investment.

Conclusion

Some key overall points arising from the forum were:

- As there are now more than 2,600 bilateral investment treaties (BITs) worldwide, BITs are a fact of life for most developing countries – they cannot not easily avoid them nor escape the risk of facing investor-state disputes in the future.
- The fundamental function of investment treaties is to keep the balance between investors and host states. There is a need to rebalance treaty rights and obligations to take account of host states' right to development and to regulate in their own interest as a matter of priority in IIA negotiation.
- Although some arbitral tribunals have recognized investor obligations and the importance of development policy space for host states, the lack of precedent in international arbitration means that the only certain way to ensure these issues are addressed is through including express treaty provisions imposing obligations on investors (and possibly home states) and by expressly protecting host states right to policy space and to take measures to further its own development.
- Developing countries need to negotiate strategically with development objectives in mind, including:
 - Understanding how the IIA would strategically fit into the overall sustainable development policy of the country;
 - Ensuring policy space and regulatory flexibility in IIAs;
 - Setting negotiating goals clearly - knowing what the country wants and how it plans to get it in the negotiations;
 - Negotiating for the specific needs of one's own country and not accepting other countries' model treaties without careful negotiation.
 - Understanding the underlying power dynamics of negotiations e.g. constituency-building, coalitions, research and analysis;
 - Countries must be prepared to say no to an agreement. A bad agreement can leave a state worse off than no agreement.
 - Keeping good records and minutes of negotiating meetings to aid the interpretation of IIA provisions in the event of future investor-state disputes.

- Words matter. IIA provisions should be drafted as precisely and clearly as possible. Words can mean different things in different countries and in civil and common law countries. Good interaction between policymakers and legal technicians is necessary during negotiations and legal scrub phases.
- Draft IIA provisions should not be accepted without carefully understanding their meaning and their interaction with other provisions in the IIA (as well as their effect on the country's other IIAs through the "most favoured nation treatment" standard). Consideration of domestic constitutional, statutory and regulatory provisions and the other international law commitments that may be affected by the negotiated outcome are also essential.
- Host states should be internally prepared for managing investor-state disputes, including through good record-keeping of any dealings with investors.
- It is necessary to understand how investment contracts can interact with investment treaties to expand host states' treaty obligations, eg through treaty umbrella clauses.
- International investment agreements may potentially be used to help to address climate change and clean energy needs but they may also present obstacles in doing so. Coordination between investment and climate change negotiators would help to address these points.

There was strong support from participants for the need for a third annual negotiators' forum. Subject to funding, this will be held in Ecuador in fall 2009.