

Submission to the Joint Standing Committee on Treaties in respect of the *Trans-Pacific Partnership*

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A. Introduction

1. The Trans-Pacific Partnership (TPP) is a highly-sophisticated, well-balanced economic agreement. While the 30 chapters of the TPP cover a wide range of subjects - from traditional trade liberalisation through to services, environmental protection and labour standards - this submission addresses Chapter 9, which concerns investments.
2. We focus on Chapter 9 of the TPP¹ because international investment law is our field of expertise: we work on investor-State arbitrations every day, being members of the largest Investor-State Dispute Settlement (ISDS) practice in Australia. Our hope is that the practical insights we are able to offer as specialist ISDS lawyers will help the Joint Standing Committee on Treaties (JSCOT) assess some of the criticisms that have been made in relation to ISDS, both generally and as provided for under the TPP.
3. The specific objectives of our submission are to demonstrate why ISDS-backed investment treaties like the TPP are good for Australia and how the TPP addresses particular concerns raised by the public regarding Australia's potential exposure to ISDS claims.

B. TPP in context

4. In order to properly evaluate the ISDS regime of the TPP and recognise the ways in which the treaty seeks to balance investor and State rights, it is first necessary to understand the origins of ISDS and how they have influenced the development of the modern system of international investment law in which the TPP will exist.

(i) Bilateralism and the development of ISDS

5. The TPP is an embodiment of the revival of multilateralism in the area of investment promotion and protection that has occurred in recent years. Multilateral efforts were made in the area of investment during the the post-war period: first with the 1947 Havana Charter and later with the 1967 *OECD Draft Convention on the Protection of*

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¹ Unless otherwise indicated, where we refer to a particular article or provision of the TPP, we are referring to the Investment Chapter.

*Foreign Property.*² However, in this period, the views of developed ("northern"/capital-exporting) and developing ("southern"/capital-importing) States were too far apart for consensus to be reached on the *substantive* protections to be accorded to foreign investors and their property.³ As a result, the Havana Charter and the *OECD Draft Convention* never got off the ground.

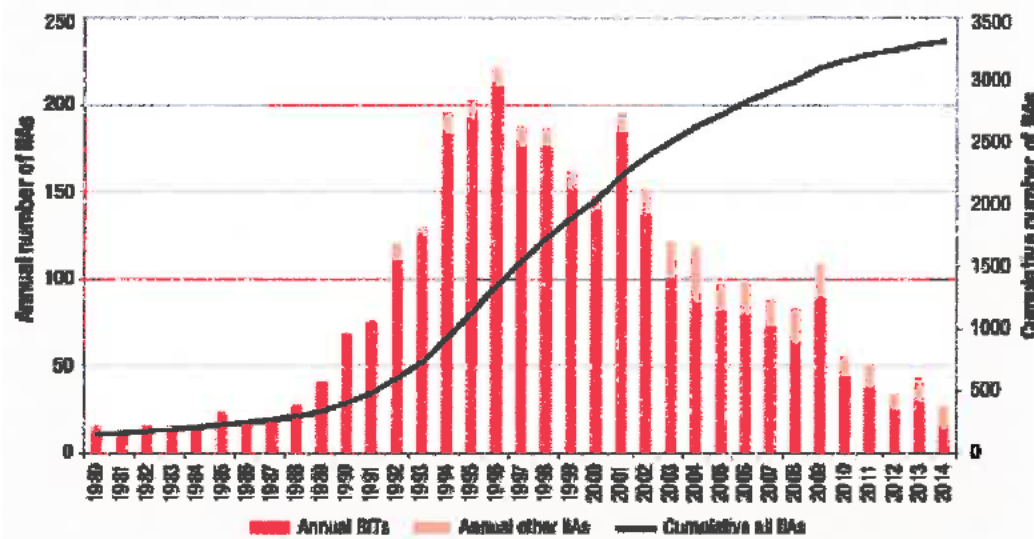
6. Nevertheless, multilateralism was effective in *procedural* terms. Although the community of nations could not agree on substantive norms for investment protection, a consensus did emerge that international arbitration was the best procedure for the resolution of investment disputes. It was from this procedural consensus that the 1965 *Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention)* was negotiated under the leadership of the World Bank,⁴ and finally agreed by both developed and developing States. Australia is an ICSID Convention country.
7. When substantive multilateralism failed, capital-exporting States pursued a default strategy of bilateralism. Negotiating "one on one", States were able to agree substantive rules for investment protection that could not be agreed by a wider group. The Bilateral Investment Treaty (**BIT**) system was thus created. To understand the current system of investment treaties, which includes BITs as well as multilateral treaties, it is instructive to look at statistics relating to: (i) the conclusion of BITs and (ii) the commencement of ISDS cases.
8. In relation to BITs, Figure 1 below shows that a significant increase in the rate of conclusion of new BITs (also known as International Investment Agreements (**IAs**)) occurred in around 1990.

² The Havana Charter was an attempt to establish the International Trade Organisation and basic rules for international trade. The OECD Draft Convention on the Protection of Foreign Property sought to give effect to certain recognised principles.

³ The multilateral revival began with the North American Free Trade Agreement (**NAFTA**) – which entered into force in 1994 – and the Energy Charter Treaty (**ECT**), which entered into force in 1998. Today, there are a growing number of multilateral investment treaties – or multilateral trade treaties that include investment provisions or chapters. The TPP is the latest example, but other examples include the Central American Free Trade Agreement (**CAFTA**) and the ASEAN Comprehensive Investment Agreement (**ACIA**).

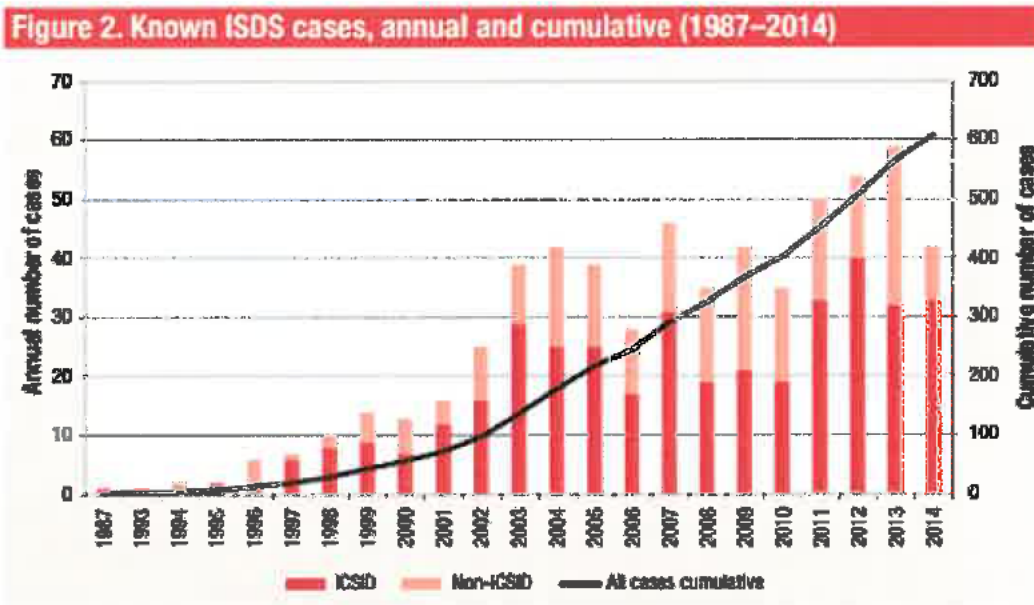
⁴ The World Bank at that time was named the International Bank for Reconstruction and Development.

Figure 1. Trends in IIAs signed, 1980-2014



Source: http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf

9. The rapid growth in the rate of new BITs in the period 1990-1996 reflects a number of major political and economic developments, including the collapse of the Soviet Union (as a result of which many newly-independent and former Soviet client States needed to realign and promote themselves to foreign investors from the West) and the formation of the World Trade Organisation (the underlying agreements of which do not cover investment protection, which, at this time, was treated as a separate agenda item to trade).
10. However, it was not until well after the rate of new BITs peaked that investors began to regularly use BITs to institute ISDS proceedings, and this was ultimately what brought the ISDS system to the attention of businesses and governments. As Figure 2 below shows, the turning point was 2002:



Source: http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf

11. These graphs show that the BIT system enabled the development of ISDS and the modern system of international investment law. BITs were therefore highly effective in structural terms. However, it is precisely because contemporary ISDS owes so much to the BIT system that it is being criticised today – even in the context of multilateral treaties like the TPP, which are very different to most BITs.
12. BITs concluded prior to 2000 usually do not contain the kind of detail that we see in modern investment treaties like the TPP. Instead, the majority of early-generation BITs are short – 10 pages or so – and are focused on establishing basic rules for the promotion and protection of foreign investment, rather than elaborating on limits or exceptions to those rules.
13. Further, many pre-2000 BITs were designed to favour the foreign investor over the host State, for the simple reason that this was what was needed at the time (particularly in the case of countries transitioning the democratic rule and free market systems, where foreign investors perceived there to be a high risk of nationalisation).
14. As a result, when ISDS cases were later brought against States under early-generation BITs, the arbitrators deciding these claims were required to interpret protections that were drafted in broad, open-textured terms (and for which the State's main defences lay in customary international law, rather than the text of the BIT). This open texture gave ISDS arbitrators considerable flexibility to determine the meaning of the protections at issue and how they applied to the facts of the dispute at hand.
15. Under customary principles of international law, treaty terms are to be interpreted in good faith, in accordance with their ordinary meaning, in their context and in light of

the object and purpose of the treaty in which they are contained.⁵ Applying this interpretative approach, particularly the requirement that the object and purpose of the BIT should be taken into account, the standards and protections afforded to investors under the broad terms of early-generation BITs were often read by ISDS tribunals (or at least perceived to have been read) in a way that favoured the claimant investor over the respondent State.

16. Thus, the BIT system did generate a body of case law that was arguably "pro-investor" in certain areas because, in many cases, that was the way the relevant BITs were intended to work.
17. Moreover, given the general terms that were used in early BITs, ISDS tribunals interpreted similarly-worded investment treaty rules in different and sometimes controversial ways. Without any doctrine of precedent or central investment appeal court, divergent lines of jurisprudence developed in some areas.
18. As the volume of BIT-based ISDS awards increased dramatically (from around 2002), criticisms that this jurisprudence was "pro-investor" and unpredictable became more intense, coming from both governments and civil society.
19. States responded to these criticisms by departing from the broad drafting style of the early-generation BITs, and started to negotiate new investment treaties – many of them multilateral – that contained terms formulated to rein-in BIT case law. This approach has produced a new generation of treaties that give ISDS tribunals less interpretative discretion and deliver increased predictability of outcomes in ISDS cases.

(ii) The benefits of multilateralism

20. Many of the current criticisms of the ISDS system (and treaties like the TPP) are actually criticisms of early-generation BITs. Modern multilateral treaties address these criticisms by confining and conditioning the protections and standards of treatment that have been invoked most often by claimant investors under BITs.
21. Ultimately, multilateralism is positive because it makes for more sophisticated, balanced treaties – instruments that, unlike most early-generation BITs, contain provisions specifically designed to balance the objective of foreign investment promotion and the need for States to regulate for the benefit of their citizens. The reasons for this positive effect are varied, but two factors are noteworthy: (i) negotiations for a multilateral treaty involve a far greater number and diversity of participants (parties and their representatives) and (ii) multilateral treaty negotiations usually take place over a much longer period than the negotiations that typically led to

⁵ See Article 31 of the Vienna Convention on the Law of Treaties. See generally, Romesh Weeramantry, *Treaty Interpretation in Investment Arbitration* (Oxford University Press 2012).

the conclusion of early-generation BITs.⁶

22. The other advantage is that, in forming regional blocs with common investment protection rules, multilateralism is starting to have a centralising effect on international investment law by introducing rules of more consistent and broader application, and creating permanent institutional infrastructure for their monitoring and enforcement.⁷
23. While we are still in the early days of centralisation, at present the two multilateral treaties that have the greatest centralising potential are the TPP and the Transatlantic Trade and Investment Partnership, which is under negotiation between the European Union and the United States.
24. If the public opposes multilateral instruments like the TPP, the risk is that States will revert to bilateralism – as they have in the past – and the benefits of multilateralism will be lost. That is not to say bilateralism does not still have a place in international investment law; it does, first because many existing BITs will remain in force for years to come and second because many governments will continue to see BITs as useful investment promotion tools (discussed below). But multilateralism and (at least *partial*) centralisation are more likely to lead to a durable and balanced system of international investment law for the 21st century, and this is one of the reasons countries like Australia need to participate in agreements like the TPP.

C. ISDS

25. Attached (as Annex I) is a chapter from a book co-written by one of the authors of this submission⁸ which provides background on international investment law (including BIT jurisprudence) and explains the general legal framework of investor-State arbitration, which is the last-resort process under most ISDS clauses.

(i) Rationale of ISDS clauses

26. An arbitration-inclusive ISDS clause is the teeth of an investment treaty. The investor's right to arbitrate against the State in which its investment is made (**host State**) makes the substantive rights and protections of an investment treaty enforceable. Take ISDS provisions away, and the investor is left with three options for the enforcement of its treaty rights:

⁶ As a result of these two factors, the negotiators tend to discuss the content of a treaty in much greater detail and are more able to secure more balanced rules in the final agreement. Further, the participation of multiple negotiating governments allows for collective action, with the effect that a State that may not have sufficient leverage to secure balancing provisions on its own may be able to do so by aligning itself with other governments.

⁷ BITs, on the other hand, created a system that was (and still is) individualistic and decentralised: the BIT legal framework is essentially a web of two-way promises enforced by arbitration before tribunals that are constituted to handle only the dispute at hand.

⁸ Simon Greenberg, Christopher Kee, Romesh Weeramantry, *International Commercial Arbitration: An Asia-Pacific Perspective* (Cambridge University Press 2011), Chapter 10.

- *first*, the investor can commence proceedings against its host State in the host State's own courts;
 - *second*, the investor can ask the State from which it originates (**home State**) to take steps on its own behalf (either in the form of diplomatic protection or formal state-versus-state dispute resolution proceedings); and
 - *third*, the investor can try to negotiate a contract with the host State that includes an ISDS clause.
27. Option one – action in the local courts – is of little or no use because the sovereign risk of the decision maker (the court) is essentially the same as the sovereign risk of the defendant (the host State). Regardless of whether or not the foreign investor actually suffers from “home town justice” (or bias in favour of the home State) the *perception* of this adjudicatory risk is real, and it is this perception that is reflected in sovereign risk.
28. Put another way, even if (as in Australia) the courts of the host State dispense a high quality of justice, the market reality is that the courts of the host State are still perceived by many foreign investors (and their financiers) to be riskier than a neutral, international tribunal (like that available under a good ISDS clause). So, when the investor has only local courts to turn to, the sovereign risk of its investment will be incrementally higher, and (through the Country Risk Premium (CRP) component of the cost-of-capital calculation) this will make the financing of its investment more costly.⁹
29. Thus, a country that does not offer ISDS through its investment treaty program may suffer from a reduced flow of foreign direct investment, particularly from small to medium sized businesses dependent on debt finance.
30. Option two – home State assistance through diplomatic channels – is defective for other practical reasons. The availability of diplomatic assistance depends upon the willingness of the home State to engage. Few businesses are important enough to expect their home State to weigh in on their behalf, especially where significant bilateral (government-to-government) relationships are involved.¹⁰ ISDS solves this

⁹ While empirical evidence for the impact of ISDS on the cost of project finance is lacking (for the obvious reason that such data is private), this is likely to be the subject of significant study in the coming years. At present, what can be said for certain is that, if the investor does not have access to ISDS at all, it will not be able to use the availability of neutral international arbitration as a basis for negotiating a lower rate with its lenders.

¹⁰ Further, the citizens of the home State rarely have an interest in their government fighting on behalf of specific private entities doing business abroad. It would be wrong, therefore, to think that investors take comfort in the possible availability of diplomatic protection. Moreover, even if a diplomatic settlement is reached, the investor still has no direct entitlement to any compensation paid under that settlement. The payment of the settlement amount is at the home State's complete discretion. In reality, the remote possibility of home State protection is no substitute for the certainty of direct recourse that ISDS provisions give investors.

access problem by making it possible for the investor to seek redress in its own name, without the need to involve its home government in the dispute.

31. Option three is for the investor to conclude a contract with the host State that includes an ISDS clause. This may be an option for major businesses that have the leverage to negotiate such a contract with the host State. Small to mid-sized firms, however, generally lack the leverage needed to secure terms comparable to an investment treaty, and the transactional costs of such negotiations will often be prohibitive. These kinds of barriers are eliminated when the investor has available to it an ISDS-backed investment treaty, and this in turn acts as an enabler of inbound capital flows.
32. More broadly, it should also be emphasised that, by continuing to participate in ISDS-backed investment treaties like the TPP, Australia is helping to consolidate and expand a legal system that has made international economic relations more stable and peaceful. It is to be recalled here that, in previous centuries, the absence of ISDS led in some cases to the politicisation and even militarisation of investment disputes. As the former President of the International Court of Justice, Judge Stephen Schwebel, said in 2014 (in response to calls to scrap the ISDS system), to cast aside the ISDS system now would be "*one of the profoundest misjudgements ever to afflict the procedures of peaceful settlement of international disputes.*"¹¹
33. Attached (as Annex II) is a paper published by one of the authors that expands on the points above.¹²

(ii) ISDS as an investment promotion tool

34. From the perspective of the Australian public, TPP Chapter 9 is beneficial because it will help Australia attract foreign investment, the benefits of which include expansion of the tax base.
35. Attracting foreign investment is a highly competitive business: even countries like Australia, blessed with vast natural resources and stable government, must actively sell themselves as investment destinations to capture inbound capital flows. And, as the mobility of capital increases, so does the competition to attract it.
36. As an indication of the competition that Australia faces in attracting foreign investment, we can look at the treaty programs of other countries in the Asia-Pacific:
 - Vietnam, Malaysia, South Korea and China have signed or ratified 64, 73, 95 and 134 BITs respectively; Australia has signed or ratified only 22 BITs;
 - Japan (a TPP signatory) is closer to Australia's BIT tally, having signed or ratified 28 BITs. However, since 2012, Japan has signed or ratified 12 BITs.

¹¹ Stephen Schwebel, "In Defence of Bilateral Investment Treaties", Keynote Address to International Council for Commercial Arbitration, 7 April 2014, available at http://www.arbitration-icca.org/media/2/14169776244680/schwebel_in_defence_of_bits.pdf

¹² Sam Luttrell, "Why ISDS is good for Australia", *Brief*, December 2015.

In contrast, during the same period Australia signed and ratified *one* bilateral treaty (this being the Investment Protocol with New Zealand); and

- Singapore has signed or ratified 26 Free Trade Agreements (FTAs), many of which include investment chapters; Australia has signed or ratified 17. Given that Australia faces increasing competition from Singapore in high-value-added areas such as trade in services (including financial services) Singapore's treaty program is an important regional signal.¹³

37. These figures show that, despite what certain sections of the Australian public think about the utility or desirability of ISDS-backed trade and investment treaties like the TPP, these instruments continue to be important components of the economic policies and strategies of our neighbours.

(iii) Australia's ISDS experience

38. One of the stated concerns in relation to ISDS is that, if Australia agrees to ISDS in treaties like the TPP, waves of investment claims will follow.

39. Australia has had ISDS obligations since 1988 (when Australia signed its first ISDS-backed BIT, with China). Based on publically available information, the ISDS provisions of Australian investment treaties have been formally invoked in four cases:

- *Tethyan Copper v Pakistan*¹⁴;
- *Planet Mining v Indonesia*¹⁵ (an ongoing ICSID case in which we are counsel for the claimants);
- *White Industries v India*¹⁶; and
- *Philip Morris Asia Limited v Australia*¹⁷ (dismissed at the jurisdiction stage).

40. To this list we can add two other ISDS cases involving Australian companies: *African Petroleum Gambia Ltd (Block A4) v Gambia*¹⁸ (a claim under an oil exploration licence) and *Lighthouse Corporation v Timor-Leste*¹⁹ (a claim under a fuel-supply

¹³ For a comprehensive survey of Australia's trade and investment treaty program, see Luke Nottage, "Investor-State Arbitration Policy and Practice in Australia", Final Report after the CIGI Project Symposium of 25 September 2015, available at www.cigionline.org/articles/investor-state-arbitration

¹⁴ *Tethyan Copper Company Pty Limited v The Islamic Republic of Pakistan (Decision on the Claimant's Request for Provisional Measures)*, (ICSID Arbitral Tribunal, Case No. ARB/12/1, 13 December 2012).

¹⁵ *Churchill Mining PLC and Planet Mining Pty Ltd v Republic of Indonesia*, (ICSID Arbitral Tribunal Case No. ARB/12/14 and 12/40, 12 January 2015).

¹⁶ *White Industries Australia Limited v The Republic of India (Final Award)*, (UNCITRAL, 30 November 2011).

¹⁷ *Philip Morris Asia Limited v Australia (Award on Jurisdiction and Admissibility)*, (UNICTRAL PCA Case No.2012-12, 17 December 2015).

¹⁸ *African Petroleum Gambia Ltd (Block A4) v Republic of The Gambia*, (ICSID Case No. ARB/14/7).

¹⁹ *Lighthouse Corporation Pty Ltd, IBC v Democratic Republic of Timor-Leste*, (ICSID Case No. ARB/15/2).

contract).²⁰

41. The current record is, therefore, five claims by Australian investors to one (unsuccessful) claim against Australia. This data set does not take into account:
 - the significant number of ISDS cases in which Australian majority-owned or managed companies are making claims under non-Australian BITs (relying on foreign-incorporated subsidiaries and special purpose vehicles); or
 - the various other ISDS cases involving Australian parties that have not been reported (for example, because they settled before they became public or because they have been resolved by *ad hoc* arbitration).
42. On any view, Australia's ISDS record does not support fears as to waves of claims. Quite the contrary, it shows that Australia is much more often the beneficiary of ISDS provisions than the respondent to claims under them. And even if such claims are made against Australia, that does not mean they will succeed (as the *Philip Morris* case has demonstrated). In any event, the cost of ISDS claims against Australia can only amount to a fraction of the benefit Australia enjoys by including ISDS provisions in its trade and investment treaties.
43. Based on our day-to-day experience as ISDS practitioners, we can confirm that foreign investors are very much aware of the investment treaty system, and do plan their investments to maximise the protections that ISDS-backed investment treaties offer, even for investments in countries like Australia where the rule of law is strong.
44. Further, when a sophisticated international business considers whether or not to make an investment in a particular country, attention is increasingly paid to how that country's trade and investment treaty program is evolving. A failure by Australia to ratify the TPP (and therefore agree to be bound by the ISDS-backed investment protections offered in Chapter 9) would send a negative message and might cause some investors to shift their attention to other countries, including States that *do* ratify the TPP.

F. Investment Chapter of the TPP

45. We turn now to discuss the ISDS regime in Chapter 9 of the TPP, and the substantive provisions most often relied upon by investors in ISDS cases: "Fair and Equitable Treatment" (FET) and expropriation. Thereafter, we turn to Article 9.16 of the TPP, an important balancing provision of the treaty. We close with a brief overview of some of the other provisions that the drafters of the TPP have included to limit member States' exposure to ISDS claims and address some of the criticisms that have been made of the ISDS system generally.

²⁰ For a wider survey of ISDS activity in the wider Asia-Pacific, see Sam Luttrell, "*ISDS in the Asia-Pacific: a Regional Snap-Shot*", *International Trade & Business Law Review*, Volume XIX (2016).

(i) FET

46. In an investment treaty, the FET standard operates as a guarantee fair dealing, its role being to address host State conduct that is not within the scope of the expropriation clause but which is otherwise unlawful. In early-generation BITs, FET clauses tended to be broadly worded. An example of a typical BIT FET clause is as follows:

*"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 of the other Contracting Party."*²¹

47. When compared to the typical BIT, the TPP's approach to FET is very different. The FET standard of the TPP is located at Article 9.6(1) of the Investment Chapter. It is part of a wider article titled "Minimum Standard of Treatment" (Article 9.6). Importantly, Article 9.6(2) clarifies that the applicable standard of FET for covered investments is the "*customary international law minimum standard of treatment of aliens*".
48. These words are important because there is a line of case authority to the effect that the international minimum standard sets a high bar for proving violation of FET, and, through the TPP's express references to the "minimum standard of treatment" and "customary international law" (including as the latter is elucidated in Annex 9A), the respondent (host) State is given the ability to argue that this line of authority should be applied in the interpretation of the FET standard.
49. In particular, faced with an FET claim under the TPP, a State could rely on these references to argue that the ISDS tribunal should follow the 1926 decision in *Neer v Mexico*²², in which it was held that violation of the standard of treatment of aliens (foreigners) at customary international law required conduct amounting "*to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognise its insufficiency*".
50. While the *Neer* case was not decided under an investment treaty, there have been cases where the ISDS tribunals have applied the *Neer* standard, or a close approximation of it. The most widely-cited example is *Glamis Gold v United States*²³, which was a dispute referred to ISDS under NAFTA.²⁴

²¹ This example is drawn from Article 3(2) of the United Kingdom-India BIT.

²² *L. F. H. Neer and Pauline Neer (U.S.A.) v. United Mexican States*, (1926) 4 RIAA 60 (US – Mexico General Claims Commission).

²³ *Glamis Gold Ltd v United States of America*, (Award of 8 June 2009).

²⁴ The *Glamis Gold* case related to a mine in south-eastern California known as the "Imperial Project". The developer's plan was to create three large open-pit gold mines on the land in question. The project was controversial because of its proximity to areas used by the Native Quechuan people for ceremonial and educational purposes. Importantly, the area was also protected as scenic and biologically important public land, such that mining activities were subject to special regulations and controls. Partly in response to the

51. It is also important to note that, under Article 9.22(7), the burden is on the investor to establish the content of the FET standard.²⁵ This means it is for the *investor* to prove the standard of FET that prevails at customary international law. On the assumption that the respondent State argues for a *Neer/Glamis Gold* standard, the investor's task will be to convince the arbitrators that customary international law has evolved since *Neer* such that a different (more investor friendly) standard for State conduct should be applied. If the investor fails to discharge its burden, and the tribunal applies the *Neer/Glamis Gold* standard, the investor's prospects of establishing that a change in law constitutes a breach of the TPP will decline materially.
52. Another limiting aspect of the TPP's approach to FET is Article 9.6(4), which provides that "*the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor's expectations does not constitute a breach of [the minimum standard of treatment, including FET], even if there is loss or damage to the covered investment as a result*". This text originates from an interpretive note that the US, Canada and Mexico issued under NAFTA. It reflects concern amongst States that "legitimate expectations" jurisprudence (in large part generated under broadly-worded BITs) expanded the FET standard, particularly into the areas of legislative and regulatory action.
53. It is significant that Article 9.3 refers only to the investor's "expectations", and makes no mention of *legitimate* expectations. It is strongly arguable that the provision still permits FET claims based on the latter.²⁶ The effect of this distinction is to place the burden on the claimant investor to prove that:
- it had a particular expectation at the time it invested; and

Imperial Project, the State of California took measures to mitigate the environmental damage from open-pit mining. Amongst other things, the State required the backfilling of all mines and regarding of any area located on or near any Native American sacred sites, and financial assurances as to compliance. These costs would have made the Imperial Project economically non-viable. Glamis Gold commenced arbitration against the United States under Chapter 11 of NAFTA, claiming that: (i) the State's regulatory measures (specifically, the requirement of backfilling) were tantamount to expropriation, as they had resulted in the Imperial Project being deprived of any economic value; and (ii) the measures taken by the State of California violated the FET standard because they were arbitrary and targeted the Imperial Project. Both claims were ultimately rejected by the NAFTA Tribunal. In respect of the FET claim, the tribunal said that the claimant investor had to meet a high threshold to prove a breach of the FET standard of NAFTA, holding that a violation "*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 [...]*". The Tribunal found no qualifying conduct on the part of the State of California not least because, amongst other factors, neither Glamis Gold nor the Imperial Project had been singled out: the legislation was of general application and was based on the reasoned opinions of professionals.

²⁵ There is a similar rule in NAFTA, and one of the reasons *Glamis Gold* was dismissed was that the claimant investor failed to discharge this burden.

²⁶ Part of the reason the clause is likely to be read this way is that the term "legitimate expectations" is widely used in FET jurisprudence, and so an ISDS tribunal would probably view the omission of the word "legitimate" as intentional – meaning the provision should be read as expressive of the drafters' intention to distinguish between "expectations" and "legitimate expectations".

- that expectation was *legitimate in the circumstances* – from an objective vantage (i.e. not what the investor subjectively thought to be legitimate but what third parties would consider to be a legitimate expectation given the circumstances faced by the investor).²⁷

54. If the investor is able to establish that it had a *legitimate* expectation, it will still need to establish what treatment it was entitled to under the FET provision. At this point, the State will be able to argue for a *Neer*-inspired formulation of the international minimum standard (discussed above). Even if the investor is able to convince the tribunal not to apply a *Neer*-type standard, and to instead read the FET standard in a more "investor friendly" way, the investor will need to show that the measures the State has taken are objectively unreasonable, unjustifiable and disproportionate – such that it would be unfair or inequitable for the State to take such measures without compensating the investor accordingly.
55. There are, therefore, a number of textually-embedded hurdles that need to be cleared before a legitimate expectations claim under the TPP will succeed. The discussion above focuses on the investor's case, and does not include the various defences available to the State under international law (such as necessity).
56. FET is the cause of action most often used by foreign investors to combat adverse regulation. FET is, therefore, at the heart of the "regulatory chill" theory. However, because the FET regime of the TPP is drafted to favour the host State (at least when compared to the FET regime of a typical early-generation BIT), it is unlikely that a well informed TPP Government would refrain from regulating for fear of FET claims. This means that the TPP is likely to have little if any "chilling" effect on a country like Australia.

(ii) Expropriation

57. Much like its FET regime, the TPP's expropriation regime is conditioned and elucidated in ways that are intended to limit the liability of the host State.
58. Like many of the new generation of multilateral treaties, the Investment Chapter of the TPP contains a special annex on expropriation (Annex 9B). Item 3 of the expropriation annex sets out the factors that are required to be taken into account in determining whether an indirect expropriation has occurred, these include:

- a statement that "*adverse effect on the economic value of an investment*" does

²⁷ In determining whether an investor had a legitimate expectation, an ISDS tribunal might take into account footnote 37 (in the Expropriation annex), which says that "*whether an investor's investment-backed expectations are reasonable depends, to the extent relevant, on factors such as whether the government provided the investor with binding written assurances and the nature and extent of governmental regulation or the potential for governmental regulation in the relevant sector*". While this footnote is strictly concerned with expropriation, and could therefore be argued (by an investor) to be irrelevant to an FET claim, many arbitrators would still take it into account in an FET context.

not, "*standing alone*", constitute an indirect expropriation;

- a requirement that account be taken of "*the extent to which the government action interferes with distinct, reasonable investment-backed expectations*"; and
- a requirement that the "*character of the government action*" be considered.

59. Item 3(b) of the expropriation annex provides that "[n]on-discriminatory regulatory actions that are designed to protect legitimate public welfare objectives [...] do not constitute indirect expropriations, except in rare circumstances". Further, footnote 37 directs that, in considering whether the investor had a reasonable expectation, the tribunal take into account "*the potential for governmental regulation in the relevant sector*".
60. Taking these factors together, non-discriminatory government action of a legislative nature, in a field in which there is historically high potential for regulation (such as public health or environmental protection) would be unlikely to qualify as an indirect expropriation under the TPP without Government representations as to legal stability or clear evidence that the action taken was disproportionate to the stated policy objective. This too reduces the prospect of the TPP causing "regulatory chill".

(iii) Article 9.16

61. Finally, in assessing the risk of ISDS claims that Australia will take on by ratifying the TPP (and, by extension, the prospects of the TPP causing "regulatory chill"), it is important to note that the Investment Chapter also contains a specific "balancing clause": Article 9.16.
62. Article 9.16 reads as follows:

"Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental, health or other regulatory objectives."

63. This language has origins in US treaty practice: similar text is found at Article 12(5) of the US Model Bilateral Investment Treaty; Article 11.10 of the Korea-US Free Trade Agreement is identical.²⁸ These origins are important because they shed some light on what the clause is meant to do: Article 9.16 comes from a wealthy, capital-exporting country with an advanced and stable political and legal system comparable

²⁸ Another example is Article 10.11: of the Investment Chapter of the US-Peru FTA, which is titled "Investment and Environment" and which provides: "*Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.*"

to Australia – a country where the rule of law is strong and the mostly likely source of ISDS claims is adverse regulation, rather than direct expropriation/nationalisation.

64. While the meaning and operation of Article 9.16 is debatable, we are inclined to see the clause as a quasi-declaratory provision: it communicates to investors that TPP States place great importance on health and the environment and reserve their rights to regulate in these areas and signals to incoming investors that these public policy considerations may inform the way in which the host State administers covered investments within its territory. Within Article 9.16, the words "*otherwise consistent*" work to ensure that the statement of regulatory priorities and prerogatives in Article 9.16 cannot be construed in a way that negates the standards of investor protection set out in the rest of the Investment Chapter.
65. The quasi-declaratory quality of Article 9.16 also gives it a general interpretive function, emphasising that ISDS tribunals need to take into account environmental and public health considerations when they interpret the other provisions of the TPP Investment Chapter. This interpretive function was recognised in *Al-Tamimi v Sultanate of Oman*²⁹, a case brought under the US-Oman Free Trade Agreement, Article 10.10 which is similar to Article 9.16 of the TPP.³⁰
66. It has been suggested that TPP Article 9.16 negates itself by requiring that the measures be "otherwise consistent" with the Investment Chapter.³¹ We disagree. The words "otherwise consistent" do not negate the balance of Article 9.16 because they cross-refer to the *whole* Investment Chapter, meaning they pick up both the substantive protections contained in the Investment Chapter and its various carve-outs and clarifications - including those concerning the States' right to regulate. As such, there are two facets to consistency under Article 9.16: for a positive investment protection obligation, "consistent" means the measure "*does not breach* [that positive obligation]"; for a carve-out or exception to a positive investment protection obligation, the word "consistent" means the measure "*falls within* [that carve-out or exception]".

²⁹ *Adel A Hamadi Al-Tamimi v Sultanate of Oman (Award)*, (ICSID Arbitral Tribunal, Case No. ARB/11/33, 3 November 2015) [387].

³⁰ In *Al-Tamimi*, the ICSID tribunal made the following observation: '[T]he US–Oman FTA places a high premium on environmental protection. It is uncontroversial that general principles of customary international law must be applied in the context of the express provisions of the Treaty. In the present case, Article 10.10 expressly qualifies the construction of the other provisions of [the Investment Chapter], including Article 10.5. The wording of Article 10.10 provides a forceful protection of the right of either State Party to adopt, maintain or enforce any measure to ensure that investment is "undertaken in a manner sensitive to environmental concerns", provided it is not otherwise inconsistent with the express provisions of Chapter 10.'

³¹ For example, the Columbia Centre for Sustainable Development has argued that the words "*otherwise consistent with this Chapter*" serve to "negate any protections otherwise purported to be given under [Article 9.16]". See Lise Johnson and Lisa Sachs, "*The TPP's Investment Chapter: entrenching, rather than reforming, a flawed system*", available at <http://ccsi.columbia.edu/2015/11/18/the-tpps-investment-chapter-entrenching-rather-than-reforming-a-flawed-system/>

67. Accordingly, Article 9.16 is an important provision and should be taken into account in any analysis of the TPP's potential to cause "regulatory chill".

(iv) Other "BIT reactive" aspects of the TPP

68. The TPP contains a number of other provisions that are designed to rein-in BIT practice and case law. These include:

- Article 9.1, which requires that, before an investment will be covered by the TPP, it must have "*the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk*". This qualification, which follows the approach adopted in *Salini v Morocco*³² (a BIT case), is not found in most BITs. Its effect is to limit the class of investments entitled to protection under the TPP, and to give a TPP State a posited basis for objecting to the jurisdiction of an ISDS tribunal over a claim in respect of an asset or interest that lacks the "*characteristics of an investment*";
- Article 9.5, which provides that the Most Favoured Nation (MFN) clause does not apply to international dispute resolution procedures or mechanisms such as the ISDS provision in Section B of Chapter 9. This means that the principle in *Maffezini v Spain*³³ (a BIT case) is excluded. In *Maffezini*, the ISDS tribunal held that the MFN provision in the Spain-Argentina BIT could apply to dispute resolution provisions (a number of ISDS tribunals thereafter either agreed or disagreed with this aspect of *Maffezini*, creating a body of divergent jurisprudence);
- Article 9.15, which contains a "Denial of Benefits" clause. Provisions of this kind are rarely found in early-generation BITs, but are now a standard feature of the new crop of multilateral treaties. They are a response to the practice of "treaty shopping", which (under certain conditions) allows investors to incorporate holding companies in a particular State for the sole purpose of taking advantage of that State's treaty program;
- Articles 9.23 and 9.24, which address perceptions that ISDS proceedings are conducted "behind closed doors" and by "secret tribunals", even though they may affect the public at large (for example, in cases concerning measures to protect public health or the environment). Subject to certain conditions and exceptions, the TPP requires ISDS pleadings, hearings and decisions to be accessible by the public, much like national court procedures. Indeed, the TPP

³² *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco* (ICSID Arbitral Tribunal, Case No ARB/00/4, Decision on Jurisdiction of 23 July 2001).

³³ *Emilio Agustín Maffezini v. Kingdom of Spain (Award)* (ICSID Arbitral Tribunal, Case No ARB/97/7, 9 November 2000).

goes further by permitting *amicus curiae* submissions from persons who are not disputing parties;³⁴ and

- Article 29.5 of Chapter 29 of the TPP, which excludes tobacco control measures from the scope of the ISDS arbitration provisions in Section B of the Investment Chapter. This is a direct reaction to the *Philip Morris v Australia* case, which was (unsuccessfully) brought under the Hong Kong-Australia BIT.

69. If we can be of any further assistance to JSCOT, please let us know.

Submitted on the 15th day of March 2016

Dr Sam Luttrell

Dr Romesh Weeramantry

**C L I F F O R D
C H A N C E**

³⁴ On the need for transparency in investment arbitration, see Toby Landau QC and Romesh Weeramantry, "A Case for Transparency in Investment Arbitration", in Meg Kinnear (ed.), *Building International Investment Law: The First 50 Years of ICSID* (Kluwer 2016), p.669.

ANNEXURE I

International Commercial Arbitration

An Asia-Pacific Perspective

Simon Greenberg
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- 102 (1) The legal rights involved generally arise out of treaties and public international law, rather than from domestic law or contracts.
- (2) In the case of ICSID arbitrations, the arbitral process is almost completely delocalized.³

102 A dedicated chapter on investment treaty arbitration is included in this book not only because of its growing importance and frequency of use but also because it provides a wealth of comparative material for international commercial arbitration.

103 This chapter proceeds with an overview of international investment law in Section 2. Investment treaties and their dispute settlement clauses are discussed in Section 3. Various features of ICSID and its jurisdictional requirements are examined in Section 4. The chapter then deals with the advantages, disadvantages and innovative features of the ICSID Convention in Section 5. Subsequently, aspects of international investment law are briefly surveyed in Section 6. Section 7 outlines the remedies available under investment treaties. This chapter concludes with a discussion of the attainment and enforcement of ICSID awards, respectively, in Sections 8 and 9.

2 International investment law

104 The legal framework of modern international investment law has been established primarily through treaties. They take the form of BITs⁴ or multilateral treaties.⁵ These treaties aim to protect and promote foreign investments as well as to develop the economy of the state in which the investment is made (the host state). The framework strives to increase inflows of foreign direct investment into countries (particularly developing nations) by:

- 105 (i) requiring that the host state treat investors in accordance with international standards;⁶
- (ii) granting foreign investors the right to institute an international arbitration against the host state if these standards are not met;
- (iii) increasingly, international commercial lawyers need to understand these rights and protections, whether or not their clients engage directly with the host state or its organs. In other words, if host state action negatively affects a foreign investor or its investment, rights to commence an arbitration against that state

³ For a discussion of ICSID's delocalization, see C. Schreuer, 'ICSID Arbitration: A New Paradigm of International Dispute Resolution', 19 ICSID Rev. 438 (2004).
⁴ For a list of BITs, see the website of the United Nations Conference on Trade and Development (UNCTAD), <http://unctad.org/e-library/databases/Trade-and-Investment-Agreements.asp>.
⁵ For a list of multilateral treaties, see the website of the United Nations Conference on Trade and Development (UNCTAD), <http://unctad.org/e-library/databases/Multilateral-Treaties.asp>.
⁶ For a list of standards, see the website of the United Nations Conference on Trade and Development (UNCTAD), <http://unctad.org/e-library/databases/Standards.asp>.

may be granted to the investor under an investment treaty even in the absence of a directly negotiated arbitration agreement between them.

10.6 The Asia-Pacific region has been associated with a number of significant developments in this area of law.⁷ Pakistan was a party to the first bilateral investment treaty (BIT) to be signed.⁸ One of the earliest and longest running ICSID cases involved an Asian state.⁹ A number of judgmentally important investment treaty awards relate to investments made in this region. And China, having concluded upwards of 120 BITs, is second only to Germany in the number of BITs any single country has concluded.¹⁰ Notwithstanding this strong connection with international investment treaties, the Asia-Pacific has not yet seen as many investment treaty arbitrations as would have been expected when compared with other regions of the world.¹¹

3 Investment treaties

10.7 BITs are treaties signed between two states pursuant to which each offers substantive standards of treatment to private investors that originate from the other state. A vast proportion of BITs also contain dispute settlement clauses (discussed below) to resolve disputes between the investor and the host state. In terms of numbers, upwards of 3700 BITs now exist.¹² UNCTAD has reported that by the end of 2008, states from Asia and Oceania had signed 41% of all BITs, i.e. a total of 1112.¹³

⁷ For other Asia-Pacific proceedings on investment arbitrations, see John Stewart, 'Investment Treaty Arbitration: A Review of the Asia-Pacific Region', 10 ICSID Rev. 438 (2004).
⁸ The first BIT was signed between Pakistan and the United Kingdom in 1959. See *Pakistan v. United Kingdom*, 19 ICSID Rev. 438 (2004).
⁹ *Chalouh v. Pakistan*, 10 ICSID Rev. 438 (2004).
¹⁰ See the website of the United Nations Conference on Trade and Development (UNCTAD), <http://unctad.org/e-library/databases/Trade-and-Investment-Agreements.asp>.
¹¹ For a list of investment treaty arbitrations, see the website of the United Nations Conference on Trade and Development (UNCTAD), <http://unctad.org/e-library/databases/Investment-Treaty-Arbitration-Cases.asp>.

¹² For a list of BITs, see the website of the United Nations Conference on Trade and Development (UNCTAD), <http://unctad.org/e-library/databases/Trade-and-Investment-Agreements.asp>.
¹³ See UNCTAD, 'Trade and Investment Statistics', 2009, at 112.
¹⁴ For a list of multilateral treaties, see the website of the United Nations Conference on Trade and Development (UNCTAD), <http://unctad.org/e-library/databases/Multilateral-Treaties.asp>.
¹⁵ For a list of standards, see the website of the United Nations Conference on Trade and Development (UNCTAD), <http://unctad.org/e-library/databases/Standards.asp>.

10.8 As mentioned previously, the first ever BIT signed was the 1959 Pöhlmann-Germany BIT. However, the number of BITs entered into during the following decade was modest – fewer than eight BITs were signed per year during that period.¹⁹ Thereafter, the numbers of BITs gradually increased until the 1990s, when a dramatic rise took place. In that decade, an average of 146 BITs were signed each year.²⁰ The upsurge in BIT numbers during the 1990s has been attributed to the end of the Cold War, the movement of many Central and Eastern European nations from socialism to free market economies and the rapid economic development of East Asian countries.²¹ Now an Asian standpoint, the recent growth of BITs has led Doberter and Schreiner to observe:²²

The most significant trends in the evolution of BIT practice in the past decade concern the negotiation of BITs by Asian states. China has concluded 117 treaties between 1992 and 2006. India, excluded in the BIT in 1994, had already entered into 26 BITs by 1999, and in 2006 was a party to 56 such treaties. Japan has decided to join the practice of other OECD countries and in 2006 was a party to 12 investment agreements.

10.9 BITs were originally signed between developed states and developing states, with the intention that this would promote the flow of investment from the former to the latter. More recently, an increasing number of BITs have been signed between developing countries.²³ Additionally, case law shows that investor claimants are now not simply from developed countries. A number of cases can be found in which investors from developing countries are invoking BITs to institute claims against developed or developing countries.²⁴

10.10 Free trade agreements (FTAs), unlike BITs, are treaties that are not solely designed to investment protection. For example, the 2009 Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area²⁵ (the ASEAN-ANZ FTA) contains 18 chapters on a diverse range of subjects, including customs procedures, electronic commerce, intellectual property, trade in goods and movement of persons. Only Chapter 11 is devoted to investment protection.²⁶ Combined trade and investment agreements often contain investment protection provisions

19 *Wunderlich*, 'The Political Economy of a Rational Investment Treaty', (2008) 91 *American Journal of International Law* 621, 627-628.
20 See UNCTAD, *International Investment Agreements: Challenges and the Way Forward*, UNCTAD Investment Instruments Database (2006), UNCTAD/IT/I/T/2006/4, 47-28.
21 See Wunderlich, op. cit. fn 21, at p. 629 and UNCTAD, *ibid.*, 48-51.

22 Doberter and Schreiner, op. cit. fn 1, 17-20-21.
23 See, e.g. *Investment v Spain*, ICSID Case No. ARB/07/17 (Oct 2007) (an OCTO Treaty was a bilateral treaty).
24 *Investment v Italy*, ICSID Case No. ARB/01/13 (Oct 2001) (an OCTO Treaty was a bilateral treaty).
25 An important multilateral treaty relevant to this region that is widely debated to investment protection is the *ASEAN-Australia-New Zealand Free Trade Agreement*, signed on 26 February 2009 by members of the Association of Southeast Asian Nations (ASEAN), the generally-11 members and 23 partners. The new ASEAN Comprehensive Investment Agreement, (2009) 50 *Asian International Arbitration Journal* 347.

similar to those found in BITs.²⁷ At the end of 2007, 254 of those treaties were in existence and at least 75 more were under negotiation.²⁸

10.11 A vital element of investment treaty arbitration is the dispute-settlement clause found in investment treaties. It grants investors a right to institute arbitration proceedings directly against a state. This type of clause represents a change from traditional international law practice whereby an investor was generally dependent on his home state to pursue a diplomatic protection claim on behalf of the investor. As will be seen below, the latter system of dispute resolution has many drawbacks for the investor.²⁹

10.12 Several different options may be provided in investment treaty dispute settlement clauses. Article 21(C) of Chapter 11 of the ASEAN-ANZ Treaty contains a good example of the alternatives:

- (A) where the Philippines or Viet Nam is the disputing Party, to the courts or tribunals of that Party, provided that such courts or tribunals have jurisdiction over such claim; or
 - (B) under the ICSID Convention and the ICSID Rules of Procedure for Arbitration Proceedings, provided that both the disputing Party and the non-disputing Party are parties to the ICSID Convention; or
 - (C) under the ICSID Additional Facility Rules, provided that either of the disputing Party or non-disputing Party are a party to the ICSID Convention; or
 - (D) under the UNCITRAL Arbitration Rules; or
 - (E) if the disputing parties agree, to any other arbitration institution or under any other arbitration rules.
- provided that resort to one of the first order Subparagraphs (A) to (E) shall exclude resort to any other.

10.13 The phrase that follows sub-para (E) is frequently referred to as a 'fork in the road' provision. It is not as simple to apply as it first appears. Whether the election of one option precludes recourse to another may depend on a number of factors, including the justified nature of the claims made in the different fora (e.g. were they both treaty-based claims?), and the parties involved in the two proceedings (e.g. were they identical in both instances?).³⁰

10.14 Usually, investment treaty dispute settlement provisions would be conditional upon the expiry of a certain period of time for amicable settlement. For example,

27 See, e.g. Economic Partnership Agreement concluded between Japan and Thailand 2007; Free Trade Agreement between Japan and the Republic of Korea 2002; Free Trade Agreement between Japan and the Republic of Korea 2002; Comprehensive Economic Cooperation Agreement between India and Singapore 2005 and Agreement between Malaysia and Japan for an Economic Partnership 2005. Other treaties, such as the Australia-SEZTA and the Agreement between Japan and the Republic of the Philippines of 1978, have been replaced by more modern investment treaty dispute settlement provisions. An illustrative example of a modern investment treaty is the BIT in the ASEAN-ANZ FTA and the ASEAN-Australia-New Zealand Free Trade Agreement. See also the ASEAN-ANZ FTA and the ASEAN-Australia-New Zealand Free Trade Agreement (signed 27 February 2009), at www.apec.org/secretariat/asean/aseananzfta.htm and the ASEAN Comprehensive Investment Agreement, at www.apec.org/secretariat/asean/aseananzfta.htm (accessed 17 May 2009).

28 See UNCTAD, *ibid.*, 48-51, p. 200, para-479 et seq.

29 See Doberter and Schreiner, op. cit. fn 1, p. 170, para-479 et seq.

30 See, e.g. *Investment v Spain*, ICSID Case No. ARB/07/17 (Oct 2007) (an OCTO Treaty was a bilateral treaty).
31 See, e.g. *Investment v Italy*, ICSID Case No. ARB/01/13 (Oct 2001) (an OCTO Treaty was a bilateral treaty).
32 An important multilateral treaty relevant to this region that is widely debated to investment protection is the ASEAN-Australia-New Zealand Free Trade Agreement, signed on 26 February 2009 by members of the Association of Southeast Asian Nations (ASEAN), the generally-11 members and 23 partners. The new ASEAN Comprehensive Investment Agreement, (2009) 50 *Asian International Arbitration Journal* 347.

in Chapter 11 of the ASEAN-ANZ Treaty, Article 19 requires amicable resolution through consultation but if the dispute cannot be settled amicably within 180 days, Article 20 permits the investor to refer the dispute to arbitration.²⁵

4 The International Centre for Settlement of Investment Disputes (ICSID)

4.1 Background and structure of ICSID

10.15 A short history of the ICSID Convention is provided in Chapter 1, Section 2.3.2. ICSID is an international institution established pursuant to Article 1 of the ICSID Convention. It is based in Washington DC, USA. The centre offers special autonomous procedures for settling investment arbitrations between a state (i.e. a government) or state entity and a foreign private investor. ICSID was created as an independent international organisation²⁶ but it is structurally linked to the World Bank. The bank's governors sit or officiate on ICSID's Administrative Council (described below), the Chairman of the Administrative Council is the World Bank's President and the ICSID Secretary (described below) is funded through the World Bank.²⁷

10.16 The two constituent bodies of ICSID are its Administrative Council and Secretariat. The Administrative Council is composed of all ICSID Convention contracting states. Essentially, its functions as the governing body of ICSID, possessing the power to adopt and approve the Centre's budget, administrative regulations and rules of arbitral procedure.²⁸ The ICSID Secretariat, on the other hand, provides the day-to-day administrative and support functions for arbitrations, much like most arbitral institutions.

10.17 Initially, the number of case registrations at ICSID was low. In the five years that followed the ICSID Convention's entry into force in 1966, 80 cases were registered with ICSID²⁹ and between 1968 to 1996, only 35 ICSID cases were registered – an average of approximately one per year.³⁰ Today, the picture is fundamentally different. From 1996 through 2005, 166 ICSID cases were registered and in November 2009, a total of 121 cases were pending before

²⁵ This is analogous to well-known dispute resolution clauses discussed in Chapter 4, Section 9.4 of this book. Some ICSID tribunals have not treated arbitrations with ICSID as the preferred method. See, e.g. *AT & T Intellectual Property I* (ICSID Award No. 81/1), 19 ICSID Reports 488, at para. 104 and *Impregilco v. Ukraine*, 16 ICSID Reports 200, at para. 100. See also *Investment Disputes* (2009), 16 ICSID Reports 199, at para. 1.4.3.

²⁶ Article 18 of the ICSID Convention states: 'The Centre shall have full international legal personality, the legal capacity of the States and include the capacity: (a) to contract; (b) to acquire and dispose of movable and immovable property; (c) to institute legal proceedings.'

²⁷ See ICSID Convention Article 6, 4, 5, and the World Bank, *A Guide to the World Bank*, 2008, p. 46.

²⁸ See ICSID Convention Article 6, and *ICJ Reports*, The ICSID Convention: A Commentary, Cambridge University Press, 2008, pp. 38–51.

²⁹ *Statutory Instruments* (ICSID) Case No. ANU/797/0 was the first case to be registered at ICSID, on 25 January 1972. It was settled and discontinued on 27 October 1972.

³⁰ See *Investment Disputes* (2009), at para. 1.4.3. See also *Investment Disputes* (2009) and *ICJ Reports*, *Investment Treaty Arbitration and Public Law*, Oxford University Press, 2007, p. 28.

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ICSID.³¹ Several major investment treaty arbitrations are pending at other arbitral institutions.³² Two major reasons for this rise in investment treaty arbitrations are the proliferation in the 1990s of bilateral investment treaties (most of which contained ICSID dispute settlement clauses) and Argentina's financial crisis.³³

4.2 ICSID jurisdiction

10.18 Article 25(1) of the ICSID Convention is central to ICSID arbitrations. It defines ICSID's jurisdiction in the following terms:

The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally...

10.19 The key jurisdictional criteria under this provision relate to:

- (i) the nature of the dispute (*arbitrable matters*) – it must be legal and arise out of an investment;
- (ii) the parties (*arbitrable persons*) – the claimant must be a national of an ICSID contracting state and the respondent must be another ICSID contracting state and;
- (iii) the consent of the parties to have the dispute resolved in accordance with ICSID procedure.

10.20 Individual issues pertaining to the meaning of an investment, the nationality of the claimant and the consent of parties to resolve disputes under the ICSID Convention will be addressed in the following section. ICSID's Additional Facility will also be discussed, which may be used for certain claims falling outside the scope of Article 25.

4.3 Requirement of an 'investment'

10.21 As this book generally indicates, international commercial arbitration may be utilized to resolve a broad range of disputes.³⁴ In contrast, the subject matter of the disputes that may be resolved in investment treaty arbitrations is far more circumscribed. Article 25(1) of the ICSID Convention limits the jurisdiction

³¹ See *Investment Disputes* (2009), at para. 1.4.3. The ICSID Convention, The ICSID Convention – Statute, 19 ICSID Reports 10, at para. 10. The ICSID Convention entered into force on 14 October 1966. See also *Investment Disputes* (2009), at para. 1.4.3. See also *Investment Disputes* (2009), at para. 1.4.3. See also *Investment Disputes* (2009), at para. 1.4.3.

³² Two of the other active institutions that administer investment treaty arbitrations are the Stockholm Chamber of Commerce and the ICC International Court of Arbitration. See ICSID/ICC/SCC/AAA/ICAC/PCA, 1. The two ICSID investment treaty arbitrations appear to concentrate on to their constituent treaties.

³³ More than 40 investment treaty arbitrations were launched against Argentina as a result of the government's response to the Argentine financial crisis of 2000–2001.

³⁴ See generally Chapter 4, Section 9.4 of this book.

of ICSID arbitrators to 'legal disputes arising directly out of an investment between an ICSID contracting state and an investor who is a national of a different ICSID contracting state. To exercise jurisdiction over ICSID claims, many ICSID tribunals have had to determine whether an 'investment' existed within the meaning of Article 25. No definition of the term is provided in the Convention. In the words of the World Bank's Executive Directors:³⁶

No attempt was made to define the term 'investment' [in the ICSID Convention] given the essential requirement of consent by the parties, and the mechanisms through which Contracting States can make laws, in substance, if they so desire, the degree of dispute which they would or would not consider pertaining to the Centre (Article 25(3)).

10.22 This statement indicates that it was left to contracting states to define in separate instruments the scope of an investment for the purposes of the Convention. Nonetheless, and despite the fact that almost every bilateral or multilateral investment treaty expressly defines an 'investment', the question as to what constitutes an 'investment' for the purposes of Article 25 has led to considerable debate.

10.23 A number of ICSID tribunals have, independently of any definition of 'investment' in the BIT invoked, assessed that term on the basis of four criteria.³⁷ A leading case in this regard is *Sabido v Morocco* in which it was said that:³⁸

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

10.24 A different problem was taken in *Malaysian Historical Salvors Sdn Bhd v Malaysia*,³⁹ which gives importance not to the meaning of 'investment' in Article 25 but to the definition of an investment as found in BITs.⁴⁰ The majority of the 'ad hoc committee' there annulled the original tribunal's award because it failed to take into account the ICSID Convention drafters' intention that 'investment' in Article 25 was to be defined by states in their instrument providing recourse to ICSID, e.g. a BIT. In contrast to *Sabido v Morocco* it considered that the ICSID Convention's drafters rejected imposing any specific duration or pre-set monetary value in respect of the investment. It also held that the need for an economic contribution to the host state was not a jurisdictional condition that would exclude small contributions from the coverage of the ICSID Convention.

³⁶ Report of the Executive Directors on the ICSID Convention, 10 March 1966, reprinted in ICSID Reports 26, at para 27. In 1968 the World Bank came into the International Bank for Reconstruction and Development, now known as the World Bank, ICSID Arbitration in Practice, (1999) 2 International Trade Law Journal 167, at 173, 68.

³⁷ These criteria have been based in large measure on Sabido's understanding of the meaning of 'investment'. See Sabido, op. cit. at 26, p. 1461 and Sabido and Pelletier, op. cit. at 1, p. 66.

³⁸ Tribunal on Arbitration, 23 July 2001, 6 ICSID Reports 400, at para 52.

³⁹ ICSID award dated 16 April 2006.

⁴⁰ ICSID award dated 16 April 2006, at paragraph 148. See also Sabido, op. cit. at 26, p. 1461 and Sabido and Pelletier, op. cit. at 1, p. 66. The majority of one contracting party by vote of another contracting party, in relation to ICSID award by South African court, see P. Hain, 'Definition of Investment in Bilateral Investment Treaty of South Africa: Comments and Proposals', (2008) 36 Journal of International Arbitration 217.

10.25 Also relevant to this discussion is the view of some ICSID arbitral tribunals that the term 'investment' is different from 'ordinary commercial transactions,' for example, a contract for the sale of goods. They have held that disputes as to the latter fall outside the scope of the ICSID regime.⁴¹ Concrete examples of 'investments' held to fall within the scope of Article 25 of the ICSID Convention include the construction of dams and highways, the running of hotels, the provision of pre-shipment inspection services, shareholdings in privatised government entities and resources spent to salvage a shipwreck.

10.26 A final point to be made here is that certain BITs signed by countries in the Asia-Pacific region contain not only a descriptive definition of protected investments, e.g. 'every kind of asset,' but additionally include an added requirement that those investments must be invested in government 'approved projects' or be approved by a designated authority.⁴² In *Grain Processing v Malaysia*,⁴³ the investor claimed under the BIT between Malaysia and the Benelux-Luxembourg Economic Union, which required pursuant to Article 1(3) that the 'investment' be invested in a project classified as an 'approved project' by the appropriate Ministry in Malaysia. The arbitral tribunal held that it lacked jurisdiction to hear the claim because the investment - securities listed on the Kuala Lumpur Stock Exchange - was not duly authorised as an 'approved project'.⁴⁴

4.4 Nationality

10.27 Nationality is important for ICSID arbitration for two principal reasons. First, pursuant to Article 25(C) the claimant's nationality must be that of a state that is a party to the ICSID Convention. Second, if a claimant seeks to rely on consent to ICSID arbitration under a BIT, it ordinarily must have the nationality of one of the two state parties to that bilateral treaty.

10.28 If claimants are individuals, their nationality will usually be determined by the law of the country of which the claimant is (or claims to be) a national. But the question of nationality may not be straightforward, particularly where the claimant has more than one nationality. For example, under some national laws an individual may lose his or her original nationality if another nationality is subsequently acquired.⁴⁵ Also, under Article 25(2)(a) of the ICSID Convention, claimants are not permitted to institute an ICSID arbitration if they have the nationality of both the home state and host state.

The nationality of corporations is usually determined by their place of incorporation or registered office or, alternatively, the effective seat of the business

46 See, e.g. *Pelzer v. Venezuela*, Decision on Jurisdiction, 11 July 1997, 2 ICSID Reports 106, (1998) 37 International Trade Law Journal 1276, at para 62.

47 See the concrete examples relating to BIT arbitrations, Singapore, Pakistan, Indonesia, The Philippines and Thailand in D. Robinson, 'Definition of Investment: Singapore A. Malaysian Perspective', (2001) 75 Arbitration 208, at pp. 209-210.

48 *Malaysian Historical Salvors v Malaysia*, Final Award, 27 November 2006, 6 ICSID Reports 484.

49 See, e.g. *Sabido v. Morocco*, Final Award, 27 July 2004, 12 ICSID Reports 154.

(*Edge* noted).⁴⁹ Where a BIT provides that the nationality of a company is to be determined by incorporation, arbitral tribunals have generally decided applications to pierce the corporate veil and look at the nationality of its shareholders or ultimate owners.⁴⁸ Company shareholders are also usually entitled to institute arbitration proceedings under BITs. Article 25(3)(b) of the ICSID Convention and some BITs also provide that a 'business' of a home state may be legal entity that is incorporated in the host state but is controlled by nationals of the home state.⁴⁷

Corporations have been known to locate themselves deliberately in a particular country for the purpose of obtaining benefits or protection under a BIT or other treaty. This strategy appears to have gained general acceptance in international investment law. The arbitral tribunal in *Agua del Tunari SA v Bolivia*, for example, has said:⁵⁰

... it is not uncommon in practice, and - absent a particular limitation - not illegal to locate such 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.

... The language (the definition of national in many BITs) evidences the international routing of investments is entirely in keeping with the purpose of the instruments and the motivations of this state parties.

10.37 Accordingly, the arbitral tribunals rejected Bolivia's contention that the jurisdiction of the relevant company from one state to another constituted an abuse of corporate form or fraud.

4.5 Choice of law

10.32 Article 42(1) of the ICSID Convention deals with the applicable substantive law:

The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.

10.33 The principle of party autonomy concerning the choice of applicable law as encapsulated in Article 42(1) is consistent with international commercial

48 See generally, A. Sinclair, 'The Substance of Procedure Requirements in Investment Treaty Arbitration', (2003) 31 ICSID Review - Foreign Investment Law Journal 263. See also, 29 April 2004, 11 ICSID Reports 213. The law was also used in which arbitrators of the arbitral tribunal derived from the substantive arbitrator. The arbitrator was in favour of piercing the corporate veil. See also Chapter 4, Section 4.1.7 of this book.
49 See, e.g. 77A Reports 467 (1997) (1997) 4 ICSID Reports 268, at para 269 (in which arbitrators veil and establish whether or not the domestic company was objectively under foreign control). See also *Agua del Tunari SA v Bolivia*, Decisions on Jurisdiction, 21 October 2006, (2006) 29 ICSID Reports 267 (2006) 29 ICSID Reports 267, at para 269 and 272.

arbitration practice.⁴⁹ If the parties have not chosen the applicable law,⁵⁰ the arbitral tribunal must apply the law of the state party to the dispute and 'such rules of international law as may be applicable.' Although there is debate as to the meaning of the latter phrase, it appears that both the host state's law and international law will be applicable where license exists in the choice of law. And where there is a conflict between those two bodies of law, international law seems to prevail over the domestic law.⁵¹ The arbitral tribunal in *EGAT Energy Corp v Argentina* drew attention to the reasoning behind this point when it stated:⁵²

International law overrides domestic law when there is a contradiction since a state cannot justify non-compliance of its international obligations by asserting the provisions of its domestic law.

4.6 Consent to ICSID arbitration

10.34 Similar to international commercial arbitration, ICSID arbitration is available only if all parties have consented to it. Article 25(1) of the ICSID Convention speaks of 'consent in writing.' As we saw in Chapter 4, written consent to international commercial arbitration usually arises from a clause in a contract or from an independent arbitration agreement signed by all parties stipulating that any or certain disputes will be referred to arbitration. In investment arbitration, agreements submitting present or future disputes to ICSID arbitration concluded directly between the investor and host state are likewise recognized as consent within the meaning of Article 25 of the ICSID Convention, so long as all the jurisdictional criteria are satisfied.

10.35 Alternatively, the claimant and respondent need not be party to an arbitration agreement as is traditionally the case. In a claim made under an investment treaty, the ICSID system has developed a consensual basis for arbitration that does not fall within the usual understanding of mutual consent in writing to arbitration. No direct agreement between the investor and the host state is required under the ICSID regime. Rather, consent is achieved in two separate acts. The host state may express its consent through its domestic legislation⁵³ or in an investment treaty dispute settlement clause (as discussed above). The investor's consent

49 See Chapter 4, section 2.1.
50 The arbitrator may, for example, when a claim is brought before ICSID that there are no written provisions on applicable law. In these circumstances, some tribunals have held that applying the case on the basis of the BIT is consistent with the consent of the parties. *Chelco v Mexico*, ICSID Case No. ARB/00/18, at para 42 (2000) 23 ICSID Reports 294, at para 294.
51 See *The Arbitral Tribunal's Decision on Jurisdiction*, (2001) 24 ICSID Reports 268, at para 269.
52 See *The Arbitral Tribunal's Decision on Jurisdiction*, (2001) 24 ICSID Reports 268, at para 269.
53 See *The Arbitral Tribunal's Decision on Jurisdiction*, (2001) 24 ICSID Reports 268, at para 269.
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59 See *The Arbitral Tribunal's Decision on Jurisdiction*, (2001) 24 ICSID Reports 268, at para 269.
60 See *The Arbitral Tribunal's Decision on Jurisdiction*, (2001) 24 ICSID Reports 268, at para 269.

5.1 Advantages

Foreign investment usually requires the commitment of substantial amounts of capital for a long period of time, without any return on the investment for years. Such long-term ventures in foreign countries carries concomitant political risks for the investor, particularly the potential for expropriation of property rights or other negative governmental interferences. The architects of the ICSID Convention believed that the arbitration mechanism could provide a safeguard against such risk and enhance the security of foreign investments.

In addition to providing investors with direct means of arbitration against host states, thereby bypassing the need to seek diplomatic protection, the ICSID Convention grants several advantages to investors, particularly when compared with the practice and procedure common to international commercial arbitration.⁴⁹

- (i) an insulated procedural system that is the most delocalized form of arbitration in the world;⁵⁰
- (ii) the right of investors to file arbitration claims directly against the host state - this may exist even if it has not concluded an arbitration agreement or has no working relationship with the government of the host state;
- (iii) the application of international substantive rights and protections, rather than those found under domestic law; and
- (iv) an enforcement procedure under which the losing party cannot invoke any ground, such as under Article V of the New York Convention, to resist enforcement.

5.2 Disadvantages

ICSID arbitration also has disadvantages for certain investors when compared with international commercial arbitration.⁵¹ One of the more obvious drawbacks for investors desiring confidentiality is the fact that ICSID awards are usually made public.⁵² Another drawback for investors may be the 2006 amendment to the ICSID Arbitration Rules empowering ICSID arbitral tribunals to allow a 'non-disputing party' to submit written submissions regarding matters within the scope of the dispute. Further, given ICSID's jurisdictional limitations, which

⁴⁹ For a comparison between international commercial arbitration and investment arbitration, see H. M. Kinnear, *Investment Arbitration and Commercial Arbitration* (for the Title of the Dispute and the Status), 20 ICSID Materials and ICSID Year (2004), *Investment Problems in International Arbitration*, *Investment Law International*, 2004, p. 217.

⁵⁰ The ICSID Convention established an insulated arbitration system which ensures that the law of the seat of the host state is not applicable in the context of Chapter 2 arbitration. It, for instance, does not provide for any communication for a dispute to be set aside on ICSID award or any such as an ICSID arbitration.

⁵¹ For an overview of the advantages from a developing country perspective, see H. M. Kinnear, *Investment Arbitration: A Comparative Study*, *Investment Law International*, 2004, p. 25.

⁵² *Investment Arbitration* (ICSID) of the ICSID Convention provides that the Tribunal shall not publish the award without the consent of the parties. In practice, most decisions are made public. Additionally, in 2004, the ICSID Arbitration Rules were amended to require that the award 'promptly' include fully published extracts of the legal reasoning of the Tribunal' (Article 49(4)).

is deemed to be provided at a later point in time, namely, through its set of facilitating ICSID proceedings against the host state based on that domestic law or dispute settlement clause. The institution of a claim completes the 'written consent' required for ICSID arbitration. As the arbitral tribunal in *Generation Ukraine v Ukraine* explained:⁵⁴

It is fully established that an investor can accept a State's offer of ICSID arbitration considered in a bilateral investment treaty by instituting ICSID proceedings. There is nothing in the BIT to suggest that the investor must communicate its consent in a different form directly to the State ...

... It follows that the Claimant validly consented to ICSID arbitration by filing its Notices of Arbitration at the ICSID Centre.

This particular consensual process has formerly been described by Jan Paulsson as 'arbitration without privity'.⁵⁵

4.7 Additional facility

Aside from arbitration conducted under the ICSID Convention and the ICSID Rules, it is worth adding that since 1978 a set of Additional Facility Rules authorizes the ICSID Secretariat to administer disputes between states and foreign nationals that fall outside the jurisdictional ambit of the ICSID Convention. Other cases brought under the Additional Facility Rules are ones in which either the investor's home state or the host state is not a party to the ICSID Convention.⁵⁶ An important point to note is that proceedings under the Additional Facility Rules are not governed by the ICSID Convention. Consequently, Additional Facility arbitrations do not benefit from the advantages of arbitration conducted under the ICSID Convention, particularly the Convention's exclusion of domestic court involvement and its insulating and enforcement mechanisms (addressed below). The Additional Facility is frequently used to denounce investor-state arbitrations under the North American Free Trade Agreement because, unlike the US, Canada and Mexico are not parties to the ICSID Convention.⁵⁷

5 Assessment of the ICSID Convention

This section takes a closer look at the advantages and disadvantages of the ICSID Convention, particularly from the point of view of investors, and also highlights some of the Convention's innovative features.

⁵⁴ *Generation Ukraine Inc v Ukraine*, 18 ICSID Reports 240, at para 12.2 and 12.1.

⁵⁵ J. Paulsson, *Arbitration without Privity*, (1978) 10 ICSID Review - For the Investment Law Journal 220.

⁵⁶ See Article 2 of the Additional Facility Rules. The Article also provides arbitration on a non-binding basis to be administered by the ICSID Secretariat in addition to legal disputes that do not arise directly out of an investment, provided that either the home party to the dispute or the state against which the party to the dispute is a Contracting State ...

⁵⁷ Canada signed the ICSID Convention on 12 December 2004 but has not ratified it. Mexico has not signed the Convention.

were discussed in Section 4, lengthy and complex jurisdictional disputes are a common feature in ICSID arbitrations. Additional problems may be encountered in choosing an arbitrator due to the nationality requirements and other criteria stipulated in Articles 38-40 of the ICSID Convention.

10.43

Moreover, it may be difficult to predict the outcome of a case for lack of consistency in previously decided arbitral awards. This has become a significant issue because most investment treaty arbitral tribunals are required to interpret a specific investment treaty provision, say in a BIT between some A and some B. That provision is often materially similar to provisions found in other investment treaties. Consistency issues arise when these similar treaty provisions have been subject to prior interpretation by other arbitral tribunals. A burning question in investment treaty arbitration is whether an arbitral tribunal interpreting the BIT between A and B should follow prior interpretations of similar provisions in the same or other BITs.⁶³ There have been a number of instances where arbitral tribunals have not followed prior tribunal interpretations of similar treaty provisions.⁶⁴ Some commentators have made strong calls for more consistency in investment treaty arbitral tribunal awards.⁶⁵

10.44

Finally, the amount of legal costs involved in ICSID arbitrations may also prove to be a disadvantage. One reason for the high costs of ICSID arbitrations is linked to the consistency issue discussed above. The public availability of numerous investment arbitration awards on sites like *Investor-State* and *Treaty provisions* may require extensive analysis of them in the legal submissions of both sides. This process has the potential to increase legal costs significantly. The arbitral process (discussed below) may also be costly because, if successful, the original award cannot be revised – it, or parts thereof, may only be annulled and the matter must be re-submitted to a new arbitral tribunal that is constituted specifically for that purpose. This process would therefore require three separate arbitral tribunals to resolve the same case – the original arbitral tribunal, the ad hoc annulment committee and the new arbitral tribunal determining the annulled award. Further, the possibility exists for the award of the new tribunal also to be

63. See G. Trivitt, *The Interpretation of Treaties: How to Address Tribunal Jurisdictional Disputes*, in *Investment Treaty Law*, 1st ed., 2005, at 256, at p. 258. For a list of investment law awards, see www.investor-state.com/.
64. See, e.g., *Clayton & Clifton v. Canada*, 2001, 9 ICSID Reports 321. There was no binding precedent in *Clayton & Clifton* because the tribunal was constituted under the ICSID Convention, which allows for a new tribunal to be constituted to review an award. The tribunal in *Clayton & Clifton* was constituted under the ICSID Convention, which allows for a new tribunal to be constituted to review an award. The tribunal in *Clayton & Clifton* was constituted under the ICSID Convention, which allows for a new tribunal to be constituted to review an award.

65. See, e.g., R. D. Young, *The Arbitration Code in Investment Treaty Arbitration*, Publishing in *Investment Law*, 1st ed., 2005, at 256, at p. 258. See generally R. D. Young, *Investment Treaty Arbitration*, 1st ed., 2005, at 256, at p. 258.

subject to the annulment process.⁶⁶ The length of time to resolve a dispute if all (or even some) of these procedures are invoked may also be significant.

5.3 Innovative features

10.45

The ICSID Convention introduced a number of innovative features into arbitrations between investors and states. This section will deal with three characteristics of diplomatic protection, the self-contained procedure established by the ICSID Convention and the absence of a requirement to exhaust domestic remedies. Two other major innovations – concerning the annulment and enforcement of ICSID awards – are discussed in the final two sections of this chapter.

5.3.1 Extension of diplomatic protection and investor's direct rights

10.46

Traditionally, investors depended on their home states to pursue claims on their behalf against host states before an international court or tribunal. This process, known as diplomatic espousal or protection, has been circumscribed by the ICSID Convention. The International Court of Justice summarized the difficulties individuals or corporations face under the practice of diplomatic protection in the *Barcelona Traction case*.⁶⁷

The Court would have observed that, within the limits prescribed by international law, a State may exercise diplomatic protection by whatever means and to whatever extent it thinks fit, for it is its own right that the State is asserting. Should the national or legal persons on whose behalf it is acting consider that their rights are not adequately protected, they have no remedy in international law. . . .

The State may be viewed as the sole judge to decide whether its protection will be granted, to what extent it is granted, and when it will cease. It retains in this respect a discretionary power the exercise of which may be determined by considerations of a political or other nature, unrelated to the particular case. Since the claim of the State is not identical with that of the individual or corporate person whose cause is espoused, the State enjoys complete freedom of action.

10.47

A monumental shift away from these difficulties has been facilitated by the ICSID Convention's grant to investors of direct arbitration rights against states, even if the investor has no direct agreement with that state.⁶⁸ Aggrieved foreign investors who can harness rights under the ICSID Convention (or for that matter under most non-ICSID dispute settlement provisions found in modern investment treaties) are no longer subject to the considerable limitations traditionally inherent in a state's exercise of diplomatic protection.

66. Annulment of ICSID awards is discussed in Section 9 below.
67. *Barcelona Traction, Light and Power Company Ltd (Belgium v Spain)*, Judgment, (1970) ICJ Reports 3, at ¶¶ 79 and 77. See also *United States v. Mexico*, 90 O.R. 211, 213-215.
68. If the investor has a contract with a state that includes an arbitration agreement, please consult the applicable law provisions in that contract – the arbitration agreement is considered to comprise an implied waiver of state immunity from suit. See J. T. Dunoff and J. G. Trivitt, *Investment Treaty Arbitration: A Practical Guide to International Commercial Arbitration Involving States Parties*, (2005) 2120 Commentaries, in Section 1.04, at p. 147. This has been confirmed with various investment law awards.

10.48 In addition to granting investors direct access to arbitration against states, the ICSID Convention expressly excludes diplomatic protection unless a respondent state fails to comply with an ICSID award. On this point, Article 27(1) of the Convention provides:

No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this [ICSID] Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.

5.3.2 ICSID's self-contained procedure

10.49 In contrast with other arbitral institutions, ICSID procedure is self-contained and insulated from domestic court involvement during the arbitral process. This should be compared to non-ICSID forms of investment treaty arbitration, which are subject to domestic court supervision.⁶⁸

10.50 As we have seen in previous chapters, laws and arbitral rules enable domestic courts in certain circumstances, especially at the seat of arbitration, to intervene in international commercial arbitrations. This law benefits and drawbacks. Courts can offer assistance, for example hearing subpoenas to compel recalculation witnesses to attend or ordering the production of documents. On the other hand, domestic courts may sometimes interfere in the arbitral process if one party to the arbitration uses the courts to frustrate the arbitration. In sharp contrast, ICSID procedure is free from such domestic court interference. As Professor Schwab has observed, the seat of arbitration has little legal relevance.⁶⁹

10.51 The insulation of ICSID arbitral procedure from the influence of domestic courts is achieved through a number of provisions in the ICSID Convention. Under the ICSID Convention regime, domestic courts have no power to set aside ICSID awards. The only means to challenge an ICSID award is to invoke ICSID's internal annulment process in accordance with ICSID Convention Article 52. Any default appointment of arbitrators is made by the chairman of the ICSID's Administrative Council pursuant to Article 38 of the Convention. The chairman also has the power under Article 54 to disqualify arbitrators if they are challenged and the other arbitral tribunal members cannot agree on the challenge or if the challenged arbitrator is a sole arbitrator. Moreover, under Article 54, ICSID awards are automatically enforceable in a contracting state's domestic courts without any possibility of objection to enforcement as is possible under Article V of the New York Convention. None of these internal features of the ICSID arbitration process are granted to arbitrations conducted under the Additional Facility Rules or non-ICSID investment treaty arbitrations.

⁶⁸ The inability of some types of domestic courts to challenge awards made in investment treaty arbitrations is illustrated by *Chubb Impregilo v Gulf Cement Republics*, ICSID Case No. 27, ICSID Report 489; and *Dubai Maritime Canal v Mitsui Bussan Kaisha*, ICSID Case No. 3205, ICSID Report 395, 5 ICSID Reports 526. ⁶⁹ Schwab, op. cit. n. 28, p. 1392.

10.52 However, domestic courts may have a role to play in relation to provisional measures in ICSID arbitrations. Rule 39(5) of the 2006 version of the ICSID Arbitration Rules enables domestic courts to order provisional measures if the parties have so agreed in the document providing consent to ICSID arbitration.

5.3.3 Enforcement of domestic remedies not required

10.53 Under general principles of international law, the submission of a private party's claim against a state before an international tribunal (by way of diplomatic protection or otherwise) requires that party first to exhaust the domestic legal remedies available to it in the respondent state's domestic courts or tribunals. The ICSID Convention reverses this traditional international law position, and presumes that parties to the Convention have waived the requirement of exhaustion of domestic remedies unless otherwise indicated.⁷⁰ Article 26 of the ICSID Convention provides:

Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the submission of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.

10.54 Although the language of Article 26 presumes states to require that domestic remedies be exhausted, most BITs do not contain such a requirement. The absence of a need to pursue domestic remedies prevents the investor with significant advantages.⁷¹ Some investment treaties may, however, require investors first to seek redress in the courts or administrative tribunals of the host state for a certain duration of time.⁷²

6 Substantive rights and protections under investment treaties

10.55 This section contains a short overview of the main types of substantive rights or protections that host-state offers to a foreign investor under investment treaties. One problem with these rights or protections is that they are expressed in general terms (e.g. fair and equitable treatment), which makes them susceptible to a

⁷⁰ There may be exceptions to this general position. For example, whereas Article 26 presumes that a state's consent to arbitration entails an agreement to waive its right to require exhaustion of domestic remedies, some investment treaties do not contain such a presumption. See, for example, *Chubb Impregilo v Gulf Cement Republics*, ICSID Case No. 27, ICSID Report 489; and *Dubai Maritime Canal v Mitsui Bussan Kaisha*, ICSID Case No. 3205, ICSID Report 395, 5 ICSID Reports 526. ⁷¹ States of the investor's advantage of the ICSID system, in comparison with domestic legal systems, is set out in Article 54 of the Convention. ⁷² See, for example, *Chubb Impregilo v Gulf Cement Republics*, ICSID Case No. 27, ICSID Report 489; and *Dubai Maritime Canal v Mitsui Bussan Kaisha*, ICSID Case No. 3205, ICSID Report 395, 5 ICSID Reports 526. ⁷³ See, for example, *Chubb Impregilo v Gulf Cement Republics*, ICSID Case No. 27, ICSID Report 489; and *Dubai Maritime Canal v Mitsui Bussan Kaisha*, ICSID Case No. 3205, ICSID Report 395, 5 ICSID Reports 526.

⁷⁴ If one of the parties so requests, within a period of six months (18 months for disputes which involve the dispute was referred to the competent tribunal of the Contracting Party to the ICSID Convention) from the date of the award, the award shall be subject to appeal to the ICSID Appeals Tribunal. See Article 52 of the ICSID Convention.

⁷⁵ Where the Contracting Party and the investor of the other Contracting Party have so agreed.

range of different interpretations. A significant part of a given case will therefore turn on the facts at issue but may also depend on the arbitral tribunal's approach to interpretation of the treaty provisions and its attitude toward either arbitral awards that have determined similar issues.

10.58 Before discussing substantive rights, a short point on the international law of state responsibility needs to be made. A state is not automatically responsible for any conduct that is in breach of that state's investment treaty. That conduct must also be attributable to the state. The acts of state organs, such as police, army or the judiciary, are attributable to states without much controversy. Private citizens' acts may also be attributable to states in certain circumstances, for example, where they are acting under directions of the state or the state acknowledges that conduct as its own.⁷⁴ A state may also enact certain defenses, such as necessity and force majeure.⁷⁵

6.1 Expropriation

10.57 International law recognizes that a host-state may under certain conditions lawfully expropriate foreign property. Investment treaties contain this position. The legality of the expropriation depends on whether a state's conduct is:⁷⁶

- (i) for a public purpose;
- (ii) non-discriminatory;
- (iii) in accordance with due process principles; and
- (iv) accompanied by prompt, adequate and effective compensation.

10.56 If one or more of these conditions are not satisfied, the conduct of the state may constitute an unlawful expropriation that violates the investment treaty in question.

10.55 Expropriations are classified into two groups: direct and indirect. The former involves the physical seizure of the foreign investor's property or transfer of the legal title to that property to a person who is not the rightful owner. In an indirect expropriation, this title of the property may remain in the name of the investor but its use and enjoyment is deprived or significantly affected. This latter form of expropriation is more prevalent though it is usually more difficult to prove than the direct taking of property. A frequently quoted award that examined indirect expropriation is *Mediobanca v. Mediocredito Italiano*, in which the arbitral tribunal observed that expropriation could include:⁷⁷

74 See, e.g., the public international law relation as contained in Articles 4-11 of the International Law Commission's *Articles on Responsibility of States for Internationally Wrongful Acts* (2001) (ARJIS), 2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018, 2019, 2020, 2021, 2022, 2023, 2024, 2025, 2026, 2027, 2028, 2029, 2030, 2031, 2032, 2033, 2034, 2035, 2036, 2037, 2038, 2039, 2040, 2041, 2042, 2043, 2044, 2045, 2046, 2047, 2048, 2049, 2050, 2051, 2052, 2053, 2054, 2055, 2056, 2057, 2058, 2059, 2060, 2061, 2062, 2063, 2064, 2065, 2066, 2067, 2068, 2069, 2070, 2071, 2072, 2073, 2074, 2075, 2076, 2077, 2078, 2079, 2080, 2081, 2082, 2083, 2084, 2085, 2086, 2087, 2088, 2089, 2090, 2091, 2092, 2093, 2094, 2095, 2096, 2097, 2098, 2099, 2100, 2101, 2102, 2103, 2104, 2105, 2106, 2107, 2108, 2109, 2110, 2111, 2112, 2113, 2114, 2115, 2116, 2117, 2118, 2119, 2120, 2121, 2122, 2123, 2124, 2125, 2126, 2127, 2128, 2129, 2130, 2131, 2132, 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express the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of his investment without the required compensation.

10.62 Some argue that this is a standard that most states would find difficult not to con-
 10.63 tinue. Generally, however, concepts of legitimate expectations, transparency,
 predictability, consistency and denial of justice⁸⁵ have become prominent crite-
 ria in determining fair and equitable treatment. Given the broad nature of this
 standard of treatment, its breach is largely dependent on the specific facts and
 circumstances of each case.

6.3 Full protection and security

10.63 A common example of a full protection and security (FPS) protection provision
 is contained in Article 2(2) of the 1994 Cambodia-Malaysia BIT,⁸⁶ which pro-
 vides that 'Investments of investors of either Contracting Party . . . shall enjoy full
 protection and security in the territory of the other Contracting Party'.

10.64 The traditional understanding of this standard of treatment was that it pro-
 tected a foreign national from physical violence directed against his or her person
 or property. The standard does not create strict liability on the part of a state
 for any physical harm suffered by an investor or on investment. It establishes a
 state's responsibility in circumstances where it fails to exercise due diligence and
 take reasonable measures to protect the affected investor from acts of others. A
 well-known regional case in this respect is *Asian Agricultural Products Ltd v Sri
 Lanka*.⁸⁷ In that case, Sri Lankan government security forces destroyed a shrimp
 farm during a military operation against rebel forces. Although the arbitral tri-
 bunal was not able to determine whether the rebels or the government forces
 were responsible for the destruction, Sri Lanka was held responsible for failing
 to provide adequate precautions to prevent the destruction from taking place.

10.65 As is the case with a number of these investment-treaty standards, the mean-
 ing of FPS has evolved over the years. Arbitral tribunals now consider that it
 extends beyond physical security and applies to intangible assets. This standard
 of treatment may therefore be breached even if no physical violence or damage
 has been incurred.⁸⁸

6.4 Arbitrary or discriminatory treatment

10.66 To some extent, provisions prohibiting arbitrary or discriminatory treatment
 may overlap with fair and equitable treatment provisions⁸⁹ but most treaties

⁸⁵ As to the denial of justice and its relation to fair and equitable treatment, see particularly Article 14(2) of the ITC-China Trade Agreement, signed on 7 April 2008 and entered into force on 1 October 2008.
⁸⁶ Regional Agreement for the Promotion and Protection of Investments between Cambodia and Malaysia, signed on 17 August 1994.
⁸⁷ Award, 27 June 1990, 4 ICSID Reports 246, at para. 65(2).
⁸⁸ See, e.g. *CAF Occidental v. República Dominicana*, ICSID Award, 22 September 2001, 9 ICSID Reports 251, at para. 613, which observed that the commission of some acts of negligence could breach the FPS protection and security standard.
⁸⁹ Article 14(2) of the ITC-China Trade Agreement, signed 7 April 2008, entered into force 1 October 2008. For example, it breached the FPS standard but it includes an 'unambiguous and distinct' treaty consent provision (Article 14(4)).

have accorded both standards a separate and distinct status. An example of an
 arbitrary or discriminatory treatment provision is found in Article 2(3) of the
 China-Germany BIT.⁹⁰

Neither Contracting Party shall take any arbitrary or discriminatory measures against
 the management, maintenance, use, enjoyment and disposal of the investments by the
 investors of the other Contracting Party.

10.67 In the absence of a definition of 'arbitrary measures' in the relevant BIT, the
 arbitral tribunal in *Locher v Czech Republic* relied on the *Black's Law Dictionary*
 definition of arbitrary: 'depending on individual discretion; . . . founded on prej-
 udice or preference rather than on reason or fact'.⁹¹

10.68 It needs to be borne in mind that discriminatory standards in investment
 treaties are founded on international law, not domestic law. Accordingly, a
 violation of domestic law is not required to prove that conduct is discrimina-
 tory under an investment treaty. Local laws may in fact permit discrimination
 against foreigners but a state cannot rely on its own laws to avoid its international
 obligations.⁹²

6.5 National treatment

10.69 The national treatment standard compares the treatment accorded to the host
 state's investors with that provided to foreign investors. Article 4(1) of the 1999
 Australia-India BIT⁹³ declares:

Each Contracting Party shall, subject to its laws, regulations and investment policies,
 grant to investments made in its territory by investors of the other Contracting Party
 treatment no less favourable than that which it accords to investments of its own
 investors.

10.70 Overlaps may also occur in respect of this standard, particularly with the arbitrary
 and discriminatory treatment standard. Some investment treaties, especially
 those signed by the US, tend to include the proviso that the host state must
 accord to foreign investors no less favourable treatment than that it accords in
 like circumstances to its own investors.⁹⁴ Case law on this point is not fully
 settled. On the one hand, the arbitral tribunal in *Mohsen v Mexico* narrowed the
 'like circumstances' comparative exercise to firms involved in the specific line of
 business as the claimant.⁹⁵ *SD Myers Inc v Canada* on the other hand indicates a
 broader approach that may take into account the relevant 'economic sector' in
 which the investor at issue is involved.⁹⁶

⁹⁰ Agreement between the People's Republic of China and the Federal Republic of Germany on the Invest-
 ment and Reciprocal Protection of Investments, signed on 12 December 2000 and entered into force on 13
 December 2001.
⁹¹ *Locher v Czech Republic*, Final Award, 9 September 2007, 9 ICSID Reports 65, at para. 221.
⁹² Agreement between the Government of Australia and the Government of the Republic of India on the
 Promotion and Protection of Investments, signed on 16 February 1999 and entered into force on 4 May 2000.
⁹³ BIT, at para. 101.
⁹⁴ Agreement between the Government of Australia and the Government of the Republic of India on the
 Promotion and Protection of Investments, signed on 16 February 1999 and entered into force on 4 May 2000.
⁹⁵ *SD Myers Inc v Canada*, 7 ICSID Reports 341, at para. 17.
⁹⁶ *Final Award*, 13 November 2000, 8 ICSID Reports 189-90 International Legal Materials 4408, at para. 351.

provision and, as *Plama* suggests, whether it leaves no doubt that an essential dispute settlement provision may be imported.¹⁰⁰

6.6 Umbrella clauses

Umbrella clauses are investment treaty provisions that may be described as 'breach of obligations' clauses.¹⁰¹ A typical example is Article XI(2) of the Swiss-Philippines BIT:¹⁰²

Each Contracting Party shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other Contracting Party.

Clausules such as these raise the question whether they enable contractual breaches to be 'elevated' to the status of treaty violations. The two most famous cases at the forefront of this debate have strong connections with this region: *SGS v Pakistan*¹⁰³ and *SGS v Philippines*.¹⁰⁴

In *SGS v Pakistan*, the arbitral tribunal expressed concern about the number of potential claims that could be made under an umbrella clause if it were interpreted to include contract breaches. For this and other reasons, it refused to hold that a contractual breach constituted a treaty violation under the umbrella clause in the Swiss-Pakistan BIT. Only a few months later, the *SGS v Philippines* arbitral tribunal held that the umbrella clause in the Swiss-Philippines BIT could give rise to a breach of that treaty if the host state failed to observe its contractual commitments or obligations.¹⁰⁵ This latter case appears to represent the dominant view.¹⁰⁶ However, a point that bears emphasis is that not every breach of a contract will trigger an umbrella clause.¹⁰⁷

100 See *Radhu and Khawaja*, op. cit. fn. 1, p. 253; and *MJL*, *Shah* and *Yoshida*, op. cit. fn. 1, p. 257. In *Macatangay (GEO)*, it was suggested that approximately 40% of BITs include provisions relating to breaches of contract. 'Investment of the United States in Chile: A Review of the Investment Treaty System on International Investment', *Investment*, Number 2006/2, available online at www.usaid.gov/pressroom/pdfs/Investment_2006/2_2_06.pdf (revised 18 May 2007), p. 5. This study examines umbrella clauses in the BITs of twenty of the countries that are the specific focus of this book. In *Turkey v. Arab Republic of Egypt*, op. cit. fn. 6, at p. 319, the arbitral award states that the umbrella clause in the BIT between the two states was intended to ensure that the host state would observe its contractual commitments and obligations. 105 This latter case appears to represent the dominant view. 106 However, a point that bears emphasis is that not every breach of a contract will trigger an umbrella clause. 107

108 See *Radhu and Khawaja*, op. cit. fn. 1, p. 253; and *MJL*, *Shah* and *Yoshida*, op. cit. fn. 1, p. 257. In *Macatangay (GEO)*, it was suggested that approximately 40% of BITs include provisions relating to breaches of contract. 'Investment of the United States in Chile: A Review of the Investment Treaty System on International Investment', *Investment*, Number 2006/2, available online at www.usaid.gov/pressroom/pdfs/Investment_2006/2_2_06.pdf (revised 18 May 2007), p. 5. This study examines umbrella clauses in the BITs of twenty of the countries that are the specific focus of this book. In *Turkey v. Arab Republic of Egypt*, op. cit. fn. 6, at p. 319, the arbitral award states that the umbrella clause in the BIT between the two states was intended to ensure that the host state would observe its contractual commitments and obligations. 105 This latter case appears to represent the dominant view. 106 However, a point that bears emphasis is that not every breach of a contract will trigger an umbrella clause. 107

The scope of most favoured nation (MFN) treatment may vary depending on the wording of the investment treaty. Article 3(2) of the 1994 Malaysia-Indonesia BIT¹⁰⁸ provides:

Each Contracting Party shall within its territory subject investors of the other Contracting Party, so regard their management, law, enforcement or disposal of investments, as well as to any activity connected with these investments, to treatment less favourable than that which it accords to investors of any third State.

From the perspective of a Malaysian investor, the effect of this provision is to enable it to claim rights that Indonesia has afforded to non-Malaysian foreign investors that are more favourable, usually under other investment treaties concluded by Indonesia with other states.

It is generally accepted that MFN clauses apply to standards of substantive treatment afforded to investors from third states. For example, in *Rayfield v Pakistan*, the arbitral tribunal used an MFN clause to import a fair and equitable treatment clause from another treaty.¹⁰⁹ In contrast, a good deal of debate has taken place as to whether a MFN clause may also entitle the investor into a treaty of more favourable dispute settlement procedures. The arbitral tribunal in *Maffei v Spain* disagreed the debate when it applied the MFN clause in the Argentina-Spain BIT¹¹⁰ to import from the Chile-Spain BIT¹¹¹ a more favourable provision, namely, a dispute resolution clause that enabled a claimant to commence investment treaty arbitration after a six-month negotiation period and without having to seek relief in the Spanish courts.¹¹² The Argentine-Spain BIT required the claimant to resort to Spain's domestic courts for 18 months prior to instituting proceedings.

In the opposing camp is *Plama Commission Ltd v Bulgaria*.¹¹³ The arbitral tribunal in that case held that the MFN provision in the Bulgaria-Cyprus BIT¹¹⁴ did not clearly indicate that it applied to dispute settlement provisions and therefore it could not be invoked to import the ICSID arbitration provision contained in the Bulgaria-Pakistan BIT.¹¹⁵

The prevalent view in this area appears to be that the determination as to whether an MFN provision can be invoked will hinge on the language of that provision. The Government of Malaysia and the Government of the Republic of Indonesia for the Investors and Promoters of Investments, signed on 20 January 1994. 108 Article 3(2) of the 1994 Malaysia-Indonesia BIT provides: 'Each Contracting Party shall within its territory subject investors of the other Contracting Party, so regard their management, law, enforcement or disposal of investments, as well as to any activity connected with these investments, to treatment less favourable than that which it accords to investors of any third State.' 109 *Rayfield v Pakistan*, ICSID Case No. ARB/81/16, award of 15 October 1981. 110 *Maffei v Spain*, ICSID Case No. ARB/97/1, award of 20 October 1997. 111 The dispute was referred by a number of other claimants including *Shaw v Argentina*, ICSID Case No. ARB/04/1, award of 28 September 2004. 112 See *Debar and Soltescu*, op. cit. fn. 1, p. 284. 113 *Plama Commission Ltd v Bulgaria*, ICSID Case No. ARB/02/13, award of 21 February 2006. 114 *Plama Commission Ltd v Bulgaria*, ICSID Case No. ARB/02/13, award of 21 February 2006. 115 *Plama Commission Ltd v Bulgaria*, ICSID Case No. ARB/02/13, award of 21 February 2006.

6.6 Most favoured nation treatment

Each Contracting Party shall within its territory subject investors of the other Contracting Party, so regard their management, law, enforcement or disposal of investments, as well as to any activity connected with these investments, to treatment less favourable than that which it accords to investors of any third State.

From the perspective of a Malaysian investor, the effect of this provision is to enable it to claim rights that Indonesia has afforded to non-Malaysian foreign investors that are more favourable, usually under other investment treaties concluded by Indonesia with other states.

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7 Remedies

7.1 Compensation for expropriation

10.79 A vested issue in international law has been the identification and application of the standard of compensation for an expropriation. In most investment treaties, this compensation standard is expressed as 'prompt, adequate and effective',¹⁰⁸ which is also known as the Hull formula.¹⁰⁹ It is generally understood today in international investment law that inclusion of the Hull formula is a reference to the fair market value of the asset at the time of the expropriation.¹¹⁰

10.80 Nonetheless, a difference of opinion exists as to the amount of compensation to be paid in the event of an unlawful expropriation. One school of thought asserts that a higher amount may be awarded for an unlawful expropriation compared with the compensation due for a lawful expropriation of the same property.¹¹¹ Others take the view that (unlawful expropriation) as unlawful expropriation enables the arbitral tribunal to order restitution of the expropriated property and award compensation for the increase in the value of the property from the date of taking until the decision awarding compensation.¹¹²

7.2 Compensation for non-expropriatory treaty breaches

10.81 Investment treaties generally do not specify the standard of compensation that should be awarded if a host state breaches a non-expropriatory investment treaty provision. Because a treaty breach is a violation of international law, the guiding principle for compensation in such cases must also come from international law. In a well-accepted passage in the *Chorzów Factory* case, the Permanent Court of International Justice (the predecessor to the International Court of Justice) articulated the principle as follows:¹¹³

108 See Macleod, *State and Investor*, op. cit. in 1, p. 237, para 9.09.
109 That was the US Secretary of State who in 1906 referred to the formula in a notice of objection exchanged with the British Ambassador to the US. For the text of these exchanges, see G. H. White, *Right of International Law*, NY Government Printing Office, 1948, vol. 10, pp. 628-641.
110 See, e.g., *Dubois and Schmees*, op. cit. in 1, p. 97. Another problem associated with this issue is determining the type of valuation method to be used to ascertain the fair market value. This matter is complex and probably will have further developments. Valuation is no easy task beyond the scope of this book. For a general discussion of methods of valuation in investment treaty arbitrations, see J. W. W. Whelan, *Calculation of Compensation and Damages in International Investment Law*, Oxford University Press, 2009, and his earlier work, *State and Investor*, op. cit. in 1, p. 319 et seq.
111 It has been observed by *Dubois and Schmees* that damages for an illegal act may also measure the subjective position of the victim, whereas the compensation for a legal act of expropriation is based on an objective standard that takes account of what is hypothetical, noting that the victim would normally pay to a willing seller. *Dubois and Schmees*, op. cit. in 1, p. 97A.
112 See G. F. Herberich, *Investment Law*, 2nd ed., 1997, para 10.01 and 10.02.
113 *Factory at Chorzów (Germany v Poland)*, Merits, (1928) PCIJ Series A, no. 17, p. 47. See also Article 31 and 32 of the International Law Commission's 'Articles on Responsibility of States for Internationally Wrongful Acts', in Report of the International Law Commission on the Work of Its Fifty-third Session, UNGA Doc. A/56/60/10 (2003).

The essential principle contained in the actual notion of an illegal act... is that reparation must, in so far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.

10.82 Accordingly, the aim of compensation for an 'illegal act' is that the claimant is placed financially in the position in which it would have found itself, had the [treaty] breaches not occurred.¹¹⁴

7.3 Costs

10.83 Article 61(2) of the ICSID Convention gives the arbitral tribunal the discretion to apportion the costs of the arbitration. Many investment treaty arbitrations require that the fees and expenses of ICSID and the arbitrators to be shared and for each party to bear their own expenses.¹¹⁵ However, the practice is not uniform. Costs have been awarded against parties where their conduct has no warrant¹¹⁶ and, increasingly, arbitral tribunals award costs in favour of the successful party.¹¹⁷

7.4 Interest

10.84 Interest is an area in which investment treaty arbitrations is developing a practice that is distinct from the traditional position in public-international law. The issue relates to whether investment treaty arbitral tribunals are empowered to award simple or compound interest.

10.85 The traditional international law view was expressed in 1949 by *Marylele Whiteman*: '[T]here are few rules within the scope of the subject of damages in international law that are better settled than the ones that compound interest is not allowable.¹¹⁸ Her view has had a considerable influence on investor-state arbitrations in the second half of the 20th century, which tended to deny awarding compound interest.¹¹⁹

10.86 In contrast, the dominant trend in contemporary investment treaty arbitration is to award compound interest. A leading case in this regard is *Sovtef Norge*, in which the arbitral tribunal observed:¹²⁰

114 *Marylele Whiteman*, *Investment Law*, 2nd ed., 1949, para 200, 201 ICSID Reports 207, at p. 497. See generally *Equitable Treatment Standard* in *Yusuf and Kaituma*, op. cit. in 1, pp. 570-581.
115 See *M. A. S. v. Greece*, *Investment Treaty Arbitration*, 15 September 2003, 10 ICSID Reports 240, para 24.3 at 49, where the arbitral tribunal was ultimately dissatisfied with the claimant's submissions (e.g. identifying the claimant's economic transactions with the respondent, respectively, and highly business) and awarded all costs (the respondent paid into ICSID as well as a contribution of US\$200,000 towards the respondent's legal fees).
117 See G. F. Herberich, *Investment Law*, 2nd ed., 1997, para 10.01.
118 M. A. S. v. Greece, *Investment Treaty Arbitration*, 15 September 2003, 10 ICSID Reports 240, para 24.3 at 49.
119 See G. F. Herberich, *Investment Law*, 2nd ed., 1997, para 10.01.
120 *Sovtef Norge*, *Investment Treaty Arbitration*, 28 September 2003, 10 ICSID Reports 269, para 269.189.

where an owner of property has at some earlier time lost the value of his asset but has not received the monetary equivalent that then became due to him, the amount of compensation should reflect, at least in part, the additional sum that his money would have earned, had it, and the income generated by it, been advanced each year at generally prevailing rates of interest. It is not the purpose of compensation to put the claimant in the position he would have been in had the loss not occurred, but to compensate him for the loss of the use of his money. It is a mechanism to ensure that the compensation awarded [to] the claimant is appropriate in the circumstances.

8 Annulment of ICSID awards

10.67 Pursuant to Article 53 of the ICSID Convention, all awards are binding on the parties and are not subject to appeal or other remedy except as provided in the Convention. The only recourse available under the ICSID Convention is by way of the annulment process. Any party may make an annulment application. On receipt of such an application, the Chairman of ICSID's Administrative Council must appoint a three-person ad hoc committee to decide whether the impugned award should be annulled. Members of the ad hoc committee consist of (1) the nationality of any members of the tribunal that rendered the impugned award; (2) the nationality of the state party to the dispute; or (3) the nationality of the investor.¹²³ The ad hoc committee's review is limited to the five narrow grounds listed in Article 52(1):

- 10.68 Unless party may request annulment of the award by an application in writing addressed to the Secretary-General on one or more of the following grounds:
- (a) that the Tribunal was not properly constituted;
 - (b) that the Tribunal has manifestly exceeded its powers;
 - (c) that there was corruption on the part of a member of the Tribunal;
 - (d) that there has been a serious departure from a fundamental rule of procedure; or
 - (e) that the award has failed to state the reasons on which it is based.

An application for annulment must be made within 120 days from the date on which the award was rendered. The duration of an annulment procedure is variable. It generally ranges from about a year, if everything goes well, to around three years if complex issues arise.¹²⁴ The function of the ad hoc committee is not to annul or otherwise review the award. It has power only to annul the award in full or in part. In the event an ad hoc committee annuls an award, under Article 52(6) of the ICSID Convention, the dispute cannot be resubmitted to the original tribunal but must be submitted to a newly constituted tribunal.

123 ICSID Convention Article 52(1).
124 The process is therefore considerably longer than annulment proceedings of international commercial arbitration which are implemented in arbitrations (for example Singapore or Hong Kong). At the category of 'highly complex' cases see *Edison v. Mader* (Foreign Dispute Centre and American Energy International). They involved annulment proceedings and lasted for 28 months and 11 years, respectively. See A. Maffei, 'M. Buzan, M. Mackay and C. Peraldo, *Law and Practice of International Commercial Arbitration*, 4th ed., Praeger Publishers, 2004, para. 3-10 (citing the annulment cases but noting that cases recently in the ICSID annulment jurisdiction appear to be becoming more efficient).

9 Enforcement of ICSID awards

10.69 Article 54 of the ICSID Convention imposes an automatic duty on a contracting state to recognize and enforce any pecuniary obligations under an ICSID award as though it were a final judgment of a court of that contracting state. Domestic courts are not empowered to review ICSID awards even during the enforcement process and no national grounds such as those provided in Article V of the New York Convention can be invoked by the losing party to prevent enforcement. This feature of ICSID provides an advantage over international commercial arbitration where state courts may refuse to enforce a foreign award pursuant to Article V of the New York Convention.¹²⁵ Article 54 is, however, limited to the enforcement of 'pecuniary obligations'. Restitution or other forms of specific performance are thus not covered within the scope of this provision.¹²⁶

Once an order for enforcement of an ICSID award is granted, this is not the end of the matter. Execution of this order may need to be carried out against a specific asset, such as a bank account or other property. At this stage, Article 54 of the ICSID Convention allows the domestic court determining the execution request to apply the laws concerning the execution of judgments in force in the State in whose territory such execution is sought.¹²⁷ This position is supported by Article 55, which adds:

Nothing in Article 54 shall be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution.

This latter provision has been described by Professor Schreuer as the 'Achilles' heel of the [ICSID] Convention'.¹²⁸ He continues:¹²⁹

The self-contained nature of the procedure which excludes the intervention of the domestic courts does not extend to the stage of execution. ... The Convention does not specify the courts of States parties to the Convention to enforce ICSID awards if this would be contrary to their law governing the immunity from execution of judgments and arbitral awards. Therefore, a State whose courts refuse execution of an ICSID award for reasons of State immunity is not in violation of Art. 54.

The foregoing sentence demonstrates that from the commencement of an ICSID arbitration right up to the enforcement of the award, the arbitral process is in considerable measure insulated from domestic court involvement.¹³⁰ It is thus with a touch of irony that at the ultimate stage of the ICSID process, a domestic court is finally permitted to intervene and apply its domestic law pertaining to state immunity. This potential legal obstacle detracts somewhat from the advantages of the self-contained nature of ICSID arbitration. Nevertheless

125 This position of the New York Convention is discussed in Chapter 7, Section 6.
126 *Edison*, op. cit. in 28, p. 1194 et seq.

127 *Id.*, p. 1194.

128 *Id.*

129 There are exceptions, for example, if an applicant qualifies a party to request: *Edison* (see a domestic court pursuant to Article 54(6) of the 2006 version of the ICSID Arbitration Rules).

that Articles 54 and 55 of the ICSID Convention may prove to be a stumbling block at the finish line of the ICSID arbitral process, the ICSID system remains relatively effective. A factor often mentioned as enhancing the effectiveness of the ICSID process is seen to be the reluctance of states to be looked on unfavorably by the World Bank, particularly because of its links with ICSID and the bank's ability to provide (or withhold) significant amounts of funding for states. The veracity of this hypothesis is open to debate.²⁰

²⁰ See, e.g., *How International Commercial Arbitration Evolves* (Law International, 2009), p. 202A, n. 7 (States can often very reluctantly be seen to force awards made by ICSID tribunals, given the World Bank's importance as a lender); and J. Dolnik, M. Hutter, and M. Klein, 'State to Submission of ICSID Awards', *2009 33 Journal of International Arbitration* 1, at p. 25 (This World Bank's Operational Procedures Fund for ICSID arbitrations award. Additionally, the World Bank has not, to the authors' knowledge, spoken publicly about the consequences [being] derived from its Contracting State if that state refused to honor its obligations under the award and the ICSID Convention?).

APPENDIX 1

Asia-Pacific arbitral institutions at a glance

The table in this section provides a basic overview of some arbitral institutions mentioned in or relevant to the Asia-Pacific region.

Website	When founded/Year established	Administrative structure	Current rules	Default appointment process	Arbitrator challenge jurisdiction	Years of reference/Transmittals of cases	Award scrutiny	Costs
www.asia-arbitration.org.au	2003	Regional	UNCITRAL	UNCITRAL	UNCITRAL	10	Final and binding	UNCITRAL
www.asia-arbitration.org.au	2003	Regional	UNCITRAL	UNCITRAL	UNCITRAL	10	Final and binding	UNCITRAL
www.asia-arbitration.org.au	2003	Regional	UNCITRAL	UNCITRAL	UNCITRAL	10	Final and binding	UNCITRAL
www.asia-arbitration.org.au	2003	Regional	UNCITRAL	UNCITRAL	UNCITRAL	10	Final and binding	UNCITRAL
www.asia-arbitration.org.au	2003	Regional	UNCITRAL	UNCITRAL	UNCITRAL	10	Final and binding	UNCITRAL
www.asia-arbitration.org.au	2003	Regional	UNCITRAL	UNCITRAL	UNCITRAL	10	Final and binding	UNCITRAL
www.asia-arbitration.org.au	2003	Regional	UNCITRAL	UNCITRAL	UNCITRAL	10	Final and binding	UNCITRAL
www.asia-arbitration.org.au	2003	Regional	UNCITRAL	UNCITRAL	UNCITRAL	10	Final and binding	UNCITRAL
www.asia-arbitration.org.au	2003	Regional	UNCITRAL	UNCITRAL	UNCITRAL	10	Final and binding	UNCITRAL
www.asia-arbitration.org.au	2003	Regional	UNCITRAL	UNCITRAL	UNCITRAL	10	Final and binding	UNCITRAL

ANNEXURE II



Why ISDS is good for Australia

Dr Sam Luttrell
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INTRODUCTION

Investor-State Dispute Settlement (ISDS) is a topic of growing public debate around the world. In Australia, the ISDS debate gained new intensity last year following the introduction of the *Trade and Foreign Investment (Protecting the Public Interest) Bill 2014*, a private member's bill moved by Tasmanian Greens Senator Peter Whish-Wilson that sought to prohibit the Australian Government from entering into trade and investment treaties that contain ISDS provisions. While that Bill did not progress, it did serve to highlight some of the concerns – and misconceptions – that surround ISDS as a feature of Australia's trade and investment policy. The purpose of this article is to address some of those concerns and explain why ISDS is good for Australia.

THE ISDS DEBATE

While the public discourse on ISDS is new, the ISDS system itself is not. ISDS as we know it has existed since 1966 when the International Centre for Settlement of Investment Disputes

(ICSID), the world's leading ISDS institution, was established. But the historical origins of ISDS go back centuries. Why then is the ISDS system suddenly attracting so much attention? Fundamentally, the answer is caseload. Between 1966 and 2000, there were relatively few reported ISDS cases. However, this changed following the Argentine Economic Crisis of 1999-2002, following which a diverse range of foreign investors brought compensation claims under the ISDS provisions of Bilateral Investment Treaties (BITs). To date, over 40 claims have been made against Argentina. Almost all of these claims have been referred to international arbitration – the main method of ISDS.

In retrospect, the Argentine experience was significant for three main reasons: first it dramatically increased the group of ISDS users, the 'newcomers', including both the claimant companies themselves (some of the world's biggest businesses) and their lawyers (some of the world's biggest firms); second, the widening of the user group led to a

dramatic proliferation of knowledge of the investment treaty/ISDS system; third, it showed the users that ISDS works: not only did Argentina actively participate in the ISDS proceedings brought against it (successfully defending many claims), but the country generally complied with the awards made against it.

So, when comparable events occurred in other countries (both developed and developing), the companies and lawyers concerned knew what to do. They also had the architecture they needed: there are almost 3,000 BITs in force worldwide, with most of these instruments containing some form of ISDS clause. With every ISDS claim brought, public awareness of the system grew – to the point where, today, a system that was only a decade ago the realm of specialised legal journals is now covered by mainstream media.

Through this process, ISDS has become a political issue. In developed countries like Australia, it tends to come up in the context of Free Trade Agreements (FTAs), such as those we have recently signed with Korea and China, and the Trans-

Pacific Partnership Agreement (TPP) the text of which was recently released. In Europe, the ISDS debate is occurring in the frame of a wider public discourse surrounding the Transatlantic Trade and Investment Partnership (TTIP), the proposed economic pact between the European Union and the United States. The fact that the ISDS question arises in the context of FTAs is itself interesting: it shows how ISDS – with its origins as a device of the BIT system – has migrated into the politically-charged realm of free trade. It is with this in mind that many of the criticisms of ISDS should be considered.

RATIONALE OF ISDS CLAUSES

One of the most common 'against' arguments is that a country like Australia does not need ISDS. The problem with this view is that it only considers ISDS from our perspective and fails to consider the essential structural role that ISDS plays in international investment law: ISDS clauses give trade and investment treaties teeth.

The investor's right to arbitrate against the State in which its investment is made (host State) makes the substantive rights and protections of an investment treaty enforceable. Take ISDS provisions away, and the investor has two options for the enforcement of its treaty rights: first the investor can commence proceedings against its host State in the host State's own courts; second, the investor can ask the State from which it originates (home State) to take steps on its own behalf (either in the form of diplomatic protection or formal State-versus-State dispute resolution proceedings).

The main problems with option one – action in the local courts – are that (i) the legal system of the host State might not give the investor an effective remedy (for example, under local law, it may not be possible to obtain judicial review of the measure in question; the government agencies responsible may also have claims to sovereign immunity from jurisdiction and execution, the latter meaning the local court's decision may not be enforceable in-country even if the investor prevails) and (ii) even if the aggrieved investor does have a remedy, the sovereign risk of the decision maker (the court) will essentially be the same as the sovereign risk of the defendant (the government of the host State). Regardless of whether or not the foreign investor actually suffers from "home town justice" (or bias in favour of the home State) the perception of this adjudicatory risk is real, and it is this perception that is reflected in sovereign risk. Put another way, even if (as in Australia) the courts of the host State dispense a high quality of

justice, they are still perceived by many foreign investors (and their financiers) to be riskier than a neutral, international tribunal. So, when the investor has only local courts to turn to, the sovereign risk of its investment is relatively higher, and (as discussed below) this makes the financing of its investment more costly.

The efficiency of option two – home State assistance through diplomatic channels – is constrained by other factors.

First and foremost, the availability of diplomatic assistance depends upon the willingness of the home State to engage. Few businesses are big and important enough to expect their home State to weigh in on their behalf, especially where significant inter-government relationships are involved. Further, the people of the investor's home State rarely have an interest in their government fighting on behalf of specific private entities doing business abroad. It would be wrong, therefore, to think that investors take comfort in the possible availability of diplomatic protection. Moreover, even if a diplomatic settlement is reached, the investor still has no direct entitlement to any compensation paid under that settlement. The payment of the settlement amount is at the home State's discretion. In reality, the remote possibility of home State protection is no substitute for the certainty of direct recourse that ISDS provisions give investors.

ISDS gives a foreign investor the right to proceed against its host State in its own name, in an international forum that the host State does not control (either as a matter of fact or as a matter of appearances). The need for home State intervention is eliminated. If the investor needs to go to local courts at all (which it will may, under the terms of the applicable investment treaty), it can do so safe in the knowledge that, although an ISDS tribunal will not entertain a *substantive* review of the local court's decision, the arbitrators will review the procedure followed to ensure that no denial of justice occurred. If the investor prevails in the ISDS process, the arbitral award made in its favour will (subject to certain conditions) be enforceable against the host State in its own territory and in other countries in which it has susceptible assets – the particular enforcement regime being either that set out in the ICSID Convention (if it is an ICSID award) or the New York Convention (if the process has been conducted ad hoc or under the auspices of another arbitration body).

It should be noted that an investor may be able to obtain ISDS rights even if it is not covered by an investment treaty or ISDS-inclusive FTA. The host State may offer ISDS through its local investment

law or the investor may be able to secure an ISDS clause in a contract with the host State (such as a concession or mining licence). As to the former method, the use of host State law to convey consent to ISDS fell out of fashion during the BIT surge of the 1990s (although there are some signs it is coming back). As to the latter, while large-scale foreign investors may have the leverage needed to secure an ISDS clause in their investment contract or concession, this is less likely to be the case for smaller foreign investors (such as mining exploration companies). This is where investment treaties are useful: they make ISDS generally available to investors of the contracting States, making it easier and safer for them to do business.

ISDS AND SOVEREIGN RISK

Another reason ISDS provisions are good for Australia is that they make it cheaper for Australian companies to do business in countries with high sovereign risk: by reducing the adjudicatory (i.e. "foreign court") risk of doing business in the host State, the overall sovereign risk of the investment is lowered. The foreign investor can use the fact of it being covered by an ISDS-backed investment treaty as a basis for negotiating better terms from its lenders (although the impact that such protection will have on the cost of capital will depend upon a range of factors, including the sophistication of the financiers with whom the investor is negotiating). While empirical evidence for the impact of ISDS (or BITs coverage) on the cost of project finance is lacking (for the obvious reason that the data is private), this is likely to be the subject of significant study in the coming years. At present, what can be said for certain is that, if the investor does not have access to ISDS at all, it will not be able to make any such case to its financiers.

Historically, ISDS provisions have been intended to protect investors doing business in countries with higher sovereign risk than their home State. Where a treaty is signed between two countries that both have similar and low sovereign risk, the negotiators may not consider it necessary to include an ISDS clause. An example of an FTA that does not contain an ISDS clause is the United States-Australia Free Trade Agreement.

But this parity of sovereign risk is the exception, not the rule. The far more common scenario is one in which there is a significant *disparity* in the sovereign risk of the States that are negotiating the treaty. In this situation, the low sovereign risk State will have a strong interest in obtaining ISDS protection for its nationals when they invest in the

Pacific Partnership Agreement (TPP) the text of which was recently released. In Europe, the ISDS debate is occurring in the frame of a wider public discourse surrounding the Transatlantic Trade and Investment Partnership (TTIP), the proposed economic pact between the European Union and the United States. The fact that the ISDS question arises in the context of FTAs is itself interesting: it shows how ISDS – with its origins as a device of the BIT system – has migrated into the politically-charged realm of free trade. It is with this in mind that many of the criticisms of ISDS should be considered.

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justice, they are still perceived by many foreign investors (and their financiers) to be riskier than a neutral, international tribunal. So, when the investor has only local courts to turn to, the sovereign risk of its investment is relatively higher, and (as discussed below) this makes the financing of its investment more costly.

The efficiency of option two – home State assistance through diplomatic channels – is constrained by other factors.

First and foremost, the availability of diplomatic assistance depends upon the willingness of the home State to engage. Few businesses are big and important enough to expect their home State to weigh in on their behalf, especially where significant inter-government relationships are involved. Further, the people of the investor's home State rarely have an interest in their government fighting on behalf of specific private entities doing business abroad. It would be wrong, therefore, to think that investors take comfort in the possible availability of diplomatic protection. Moreover, even if a diplomatic settlement is reached, the investor still has no direct entitlement to any compensation paid under that settlement. The payment of the settlement amount is at the home State's discretion. In reality, the remote possibility of home State protection is no substitute for the certainty of direct recourse that ISDS provisions give investors.

ISDS gives a foreign investor the right to proceed against its host State in its own name, in an international forum that the host State does not control (either as a matter of fact or as a matter of appearances). The need for home State intervention is eliminated. If the investor needs to go to local courts at all (which it well may, under the terms of the applicable investment treaty), it can do so safe in the knowledge that, although an ISDS tribunal will not entertain a substantive review of the local court's decision, the arbitrators will review the procedure followed to ensure that no denial of justice occurred. If the investor prevails in the ISDS process, the arbitral award made in its favour will (subject to certain conditions) be enforceable against the host State in its own territory and in other countries in which it has susceptible assets – the particular enforcement regime being either that set out in the ICSID Convention (if it is an ICSID award) or the New York Convention (if the process has been conducted ad hoc or under the auspices of another arbitration body).

It should be noted that an investor may be able to obtain ISDS rights even if it is not covered by an investment treaty or ISDS-inclusive FTA. The host State may offer ISDS through its local investment

law or the investor may be able to secure an ISDS clause in a contract with the host State (such as a concession or mining licence). As to the former method, the use of host State law to convey consent to ISDS fell out of fashion during the BIT surge of the 1990s (although there are some signs it is coming back). As to the latter, while large-scale foreign investors may have the leverage needed to secure an ISDS clause in their investment contract or concession, this is less likely to be the case for smaller foreign investors (such as mining exploration companies). This is where investment treaties are useful: they make ISDS generally available to investors of the contracting States, making it easier and safer for them to do business.

ISDS AND SOVEREIGN RISK

Another reason ISDS provisions are good for Australia is that they make it cheaper for Australian companies to do business in countries with high sovereign risk: by reducing the adjudicatory (i.e. "foreign court") risk of doing business in the host State, the overall sovereign risk of the investment is lowered. The foreign investor can use the fact of it being covered by an ISDS-backed investment treaty as a basis for negotiating better terms from its lenders (although the impact that such protection will have on the cost of capital will depend upon a range of factors, including the sophistication of the financiers with whom the investor is negotiating). While empirical evidence for the impact of ISDS (or BITs coverage) on the cost of project finance is lacking (for the obvious reason that the data is private), this is likely to be the subject of significant study in the coming years. At present, what can be said for certain is that, if the investor does not have access to ISDS at all, it will not be able to make any such case to its financiers.

Historically, ISDS provisions have been intended to protect investors doing business in countries with higher sovereign risk than their home State. Where a treaty is signed between two countries that both have similar and low sovereign risk, the negotiators may not consider it necessary to include an ISDS clause. An example of an FTA that does not contain an ISDS clause is the United States-Australia Free Trade Agreement.

But this parity of sovereign risk is the exception, not the rule. The far more common scenario is one in which there is a significant disparity in the sovereign risk of the States that are negotiating the treaty. In this situation, the low sovereign risk State will have a strong interest in obtaining ISDS protection for its nationals when they invest in the

high sovereign risk State. To secure that essential protection for its investors (and the competitive benefits that come with it), it will almost always be necessary for the low sovereign risk State to agree to a reciprocal ISDS clause (i.e. a clause that allows *both* contracting States to be sued, not just the high sovereign risk State). So Australia must remain open to the inclusion of ISDS clauses even though it has low sovereign risk and reliable (and reputable) courts.

Reciprocity means that there are necessarily both benefits and detriments that flow from ISDS clauses. Obviously, the main detriment is that Australia may be subject to ISDS claims by treaty-covered foreign investors. But even if such claims are made, that does not mean they will succeed, and in any event the cost they represent can only amount to a fraction of the benefit Australia enjoys by including ISDS provisions in its trade and investment treaties.

ISDS AS AN INVESTMENT PROMOTION TOOL

In addition to the fact that, with ISDS-backed investment treaties, Australian companies are protected when they do business abroad, ISDS ensures the Australian legal framework for foreign investment remains aligned with international norms and standards, which in turn promotes and attracts foreign investment in our own territory. Here it is worth emphasising that attracting foreign investment is a highly competitive business: even countries like Australia, blessed with vast natural resources and stable government, must actively sell themselves as investment destinations to maintain inbound capital flows.

Contrary to what critics suggest, ISDS is an important investment promotion tool. As an illustration, we can look at two developing countries nearby: Indonesia and Myanmar. Indonesia has an extensive offering of ISDS through its wide-ranging investment treaty programme. But, frustrated by its experiences as a respondent in ISDS cases, Indonesia is currently reviewing its BITs (the BIT with the Netherlands has already been cancelled). Myanmar, in contrast, has only a small BIT programme, but is committed to promoting itself as a destination for foreign investment – particularly as a means of commercialising its considerable endowment of natural resources. To that end, the Myanmar Government is drafting a new Foreign Investment Law, in which it is intended that an offer of ISDS will be made. This is an example of a new market using ISDS as a tool to compete with an established market. Of course, Australia is not

Myanmar or Indonesia, but we do have similar things to sell.

Ultimately, whether or not the Australian public see the availability of ISDS as "necessary or attractive" is irrelevant: the fact is many foreign investors (and their advisors) do. No doubt many readers will have experience advising major international businesses on foreign investments and acquisitions, and will know first-hand the rigour with which these actors approach investment planning and decision making. If ISDS is not available through the target host State's treaty programme (or its local law – which is rare), then the question will be whether the client investor can secure an ISDS clause in a direct contract with the Government (i.e. State Agreement). As noted above, this will depend on the investor's bargaining power. But, if Australia refuses to accept the inclusion of ISDS clauses in its trade and investment treaties and also refuses to sign State Agreements that confer equivalent ISDS rights, this last resort will not be available. Major investors may well look elsewhere.

In any event, ISDS provisions are established features of trade and investment treaty practice. If Australia stops accepting ISDS provisions in future agreements, our trade and investment treaty programme will stall – or, at the very least, start to "lose its teeth". While the Australian treaty programme currently covers a reasonable range of countries, it provides only limited protection for other regions that will be important to Australian trade in the future. For example, treaty coverage is currently lacking for certain emerging markets in Africa, where sovereign risk tends to be high but there is real need for foreign capital. ISDS-backed treaties are needed to promote Australian investment in these developing countries.

REALITY OF AUSTRALIA'S ISDS EXPERIENCE

One of the key messages of the ISDS debate is that, if we accept these provisions in our trade agreements, we will face waves of claims. However, the record shows that Australia is much more often the benefit of ISDS provisions than the respondent to claims under them.

Based on publically available information, the ISDS provisions of Australian investment treaties have been formally invoked in four cases: *Tethyan Copper v Pakistan*, *Planet Mining v Indonesia*, *White Industries v India* and *Phillip Morris Asia Limited v Australia*. To this list we can add two other ISDS cases involving Australian companies: *African Petroleum Gambia Ltd (Block A4) v Gambia* (a claim under

an oil exploration licence) and *Lighthouse Corporation v Timor-Leste* (a claim under a fuel-supply contract). The only recorded ISDS action against Australia is the plain packaging case (*Phillip Morris Asia Limited v Australia*), a matter that has attracted a great deal of attention due to the questions of public health involved.

The current record is, therefore, five claims by Australian investors to one claim against Australia. And this is without taking into account:

- the significant number of ISDS cases in which Australian majority-owned or managed companies are making claims under non-Australian BITs (relying on foreign-incorporated subsidiaries and special purpose vehicles); or
- other ISDS cases involving Australian parties that have not been reported (for example, because they have been resolved by *ad hoc* arbitration).

In policy terms, it would be a mistake to make too much of one case against Australia, especially given that it is yet to be decided. It is also significant to note that, of the five claims brought by Australian investors against foreign host States, all claims related to activities in the energy and resources sector – an area in which a significant number of Australian companies (including many managed from Perth) operate internationally.

IMPORTANCE OF THE ISDS SYSTEM TO THE INTERNATIONAL RULE OF LAW

One of the less obvious benefits of the ISDS system is that it contributes to the international rule of law. The very fact that there is a growing dialogue about ISDS and State rights shows how effective the system has been at promoting respect for the international rule of law – if this was not the case, States would simply ignore awards against them.

On any view, the current system is a lot better than what we had before. We all have an interest in promoting the rule of law and leaving behind the days of gunboat diplomacy – when countries used the threat of military force to obtain reparations for measures taken by foreign powers against the property of their nationals. As the former President of the International Court of Justice, Judge Stephen Schwebel, said in 2014, to cast aside the ISDS system now would be "one of the profoundest misjudgements ever to afflict the procedures of peaceful settlement of international disputes".

It is critical that countries like Australia remain active participants in the ISDS system (and, in the rare event they

are sued, the ISDS process), both for the broader reason Judge Schwebel identified and for reasons of their own national interest. If Australia opposes ISDS, we will place ourselves in the unlikely company of a small group of countries that have rejected the ISDS system (examples being Venezuela, Ecuador and Bolivia). Doing so would also put us at odds with our major regional trading partners, including the Association of South East Asian Nations (ASEAN) and the People's Republic of China, whose current practice is to include ISDS clauses in their trade and investment treaties.

No system of justice is perfect, nor will it ever be. The ISDS system has its issues, but it is still relatively young. Many of the aspects of the ISDS system that critics identify as flaws are actually structural consequences of decentralisation: variation in the case law on key investment protection standards, divergent approaches to procedural issues that bear on the transparency of the ISDS process, the absence of a standing corps of arbitrators (and problems arising out of the party-appointment system for arbitrators), the lack of an appellate jurisdiction. These structural features have origins in the fact that, for the last three decades or so, States have tended to rely on bilateral instruments (namely BITs) to convey their consent to ISDS procedures (and to set out the substantive rules of the game). The result has been the development of an international investment law system in which there are thousands of 'constitutions' (some similarly worded, others very different), each with its own 'court'. But multilateral instruments (such as FTAs) are taking over from BITs as the preferred means of engagement in the area of investment promotion and rule-making. In this process, the age of bilateralism/decentralisation is ending and a new era of multilateralism/centralisation is beginning, in which the ISDS system will be consolidated and improved. The TPP is a good example. Countries like Australia have important roles to play in this renovation process.

THE WEAKNESS OF THE REGULATORY CHILL THESIS

Another common argument against the ISDS system is that it limits a State's right to regulate, causing regulatory chill. In his second reading speech in support of the *Trade and Foreign Investment (Protecting the Public Interest) Bill 2014*, Senator Whish-Wilson made direct reference to this theory:

The influence of ISDS goes beyond the direct impact of

cases. In their 2010 report the Productivity Commission identify the phenomenon of 'regulatory chilling.' In other words ISDS provisions mean governments second guess themselves on whether a public policy initiative will cause an arbitration claim to be made against them by a foreign corporation.

Regulatory chill is a complex thesis and is, as many of its proponents would concede, still being developed. Although studies in the field have moved on considerably from when the Productivity Commission released its report in 2010, empirical evidence for the phenomenon is still lacking. But that does not mean it should be dismissed, only that more work needs to be done before regulatory chill can be considered a reliable policy premise.

At the moment, the best evidence for regulatory chill is anecdotal. There have been cases where, faced with claims under ISDS clauses, States have backed down, and arguably legitimate measures have been – rightly or wrongly – reversed (Australia is not an example, as the plain packaging claim is being defended). But settlements are a feature of every dispute resolution system, and the terms of settlements naturally vary from case to case. It would be wrong to suggest that settlements necessarily represent victories for the investor.

Further, as the 42% rate of State victory cited by Senator Whish-Wilson in his second reading speech shows, States have good chances of successfully defending legitimate public interest measures in an ISDS process (especially when they are represented by skilled counsel, of whom Australia has no shortage). In defending measures they have taken in the public interest, States have a range of international law principles and doctrines at their disposal, including rules against abuse of process, limitations on the types of investments given protection, the defence of necessity, pleas based on police powers (i.e. the sovereign right to regulate), State-friendly readings of the fair and equitable treatment standard and rules for the review and annulment of ISDS tribunal decisions. It is open to Australia to continue to negotiate for the inclusion of provisions that clarify, codify or expand these rules and principles in future trade and investment treaties – as the Government did in the FTAs with Korea and China and as it has in the TPP.

COSTS OF ISDS FOR THE RESPONDENT STATE

Another criticism levelled against ISDS is that it costs States vast amounts

of money to defend meritless claims. Where a State has to defend itself in an ISDS procedure, legal fees represent a significant (if not dominant) part of the fees it will incur. But the host State is likely to incur significant legal expenses even without ISDS, because it will either have to defend itself in its own courts (where, in contrast to ISDS, there will likely be multiple levels of appeal) or respond to measures taken by the investor's home State, or both. So, for the host State, investment disputes carry cost consequences in any event, and these costs are higher when the dispute plays out in multiple forums. ISDS is, in contrast, a single procedure.

However, the main cost-benefit of ISDS is macroeconomic. As a procedure, ISDS allows the dispute to be resolved in a way that does not require its escalation to the inter-State plane. This is important because, when a dispute does play out on the inter-State plane, the bilateral trade and diplomatic relations of the host State and the home State may be damaged. ISDS allows States to avoid this risk and the shorter-term costs of intervening on behalf of their investors. This cost saving is, by its nature, hard to measure, but it should be taken into account.

Finally, it must also be remembered that, when an investor brings an ISDS claim and fails, the tribunal has the power to order that the investor pay some or all of the host State's costs of defence. Such costs orders are common.

CONCLUSION

At present, the Federal Government has a policy of considering the inclusion of ISDS provisions on a case-by-case basis. This policy should be maintained because ISDS is good for Australia. The Government has a range of negotiating strategies available to address the concerns that certain sections of the public have voiced in relation to ISDS – many of which stem from the decentralised nature of the system. In particular, the Government can (as it has with the TPP) negotiate for the inclusion of interpretive provisions that clarify the substantive protections and standards of treatment granted under the treaty or condition access to ISDS procedures; the Government may also back proposals for the establishment of an International Investment Court or regional ISDS appeals body, the centralising effects of which would be positive for the ISDS system. Imposing a blanket ban on ISDS clauses is neither sensible nor necessary.

BRIEF

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