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 TPP[1] 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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* International Arbitration Group, Clifford Chance. The views expressed in this submission are the authors' alone, and do not necessarily represent the views of Clifford Chance.

[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 (**IIAs**)) occurred in around 1990.

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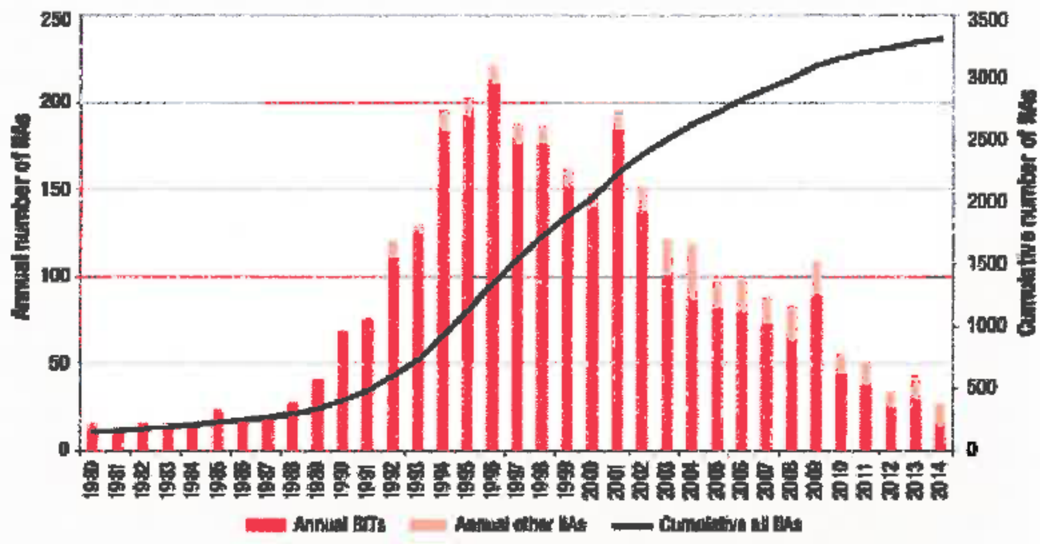
2 The Havana Charter was an attempt to establish the International Trade Organisation and basic rules for international trade. The OECD Draft Convention on the Protection of Foreign Property sought to give effect to certain recognised principles.

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

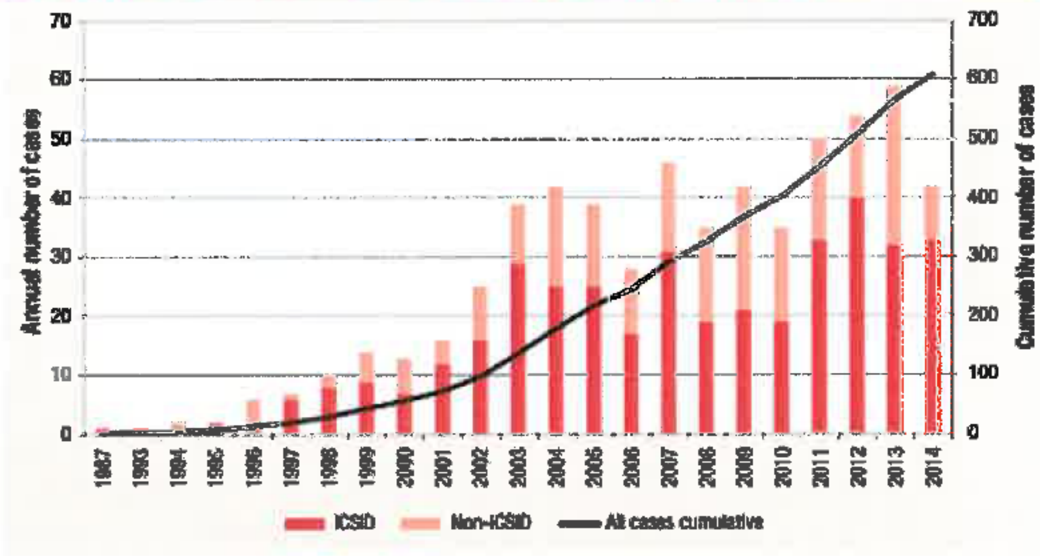


Source: http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf

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:

Figure 2. Known ISDS cases, annual and cumulative (1987–2014)



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 submission [8] 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:

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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

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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.

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[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

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[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]

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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

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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

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CLIFFORD

CHANCE

[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

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UNIVERSITY PRESS

> [W]here the State has in addition [to consenting to arbitration] committed itself under the [New York Convention or Model Law], all of which instruments impose obligations on the party to honour any arbitral award rendered, an even stronger case of implied waiver of immunity from execution of the award can be argued.

9.227 Justice Aikens' treatment of Section 14(4) of the UK State Immunity Act 1978 in *AIG Capital Partners Inc v Kazakhstan*[314] is also noteworthy. That provision states that the property of a foreign state's central bank is immune from enforcement in English courts. Justice Aikens took the view that this provision 'impinge[s] on the rights of access of parties to the enforcement jurisdiction of the UK courts'.[315] Immediately thereafter he indicated that 'if severe', a restriction on the court remedies available to parties could amount to a limitation of a party's access to court in contravention of Article 6(1) of the European Convention on Human Rights.[316] But in the case before him, Justice Aikens held that the Section 14(4) restriction on enforcement against the property of a foreign state bank was legitimate and proportionate.[317] There is no equivalent multilateral human rights treaty that is in force among states in the Asia-Pacific.

9.228 To be absolutely sure that a state is not immune from the enforcement or execution of an arbitral award, an express waiver of a state's immunity from execution should be included in the arbitration agreement. Another method would be to agree with the state that it will earmark property that can be used to satisfy sums due under an award issued against a state.[318]

314 *AIG Capital Partners, Inc v Kazakhstan* [2005] EWHC 2239; [2006] All ER (Comm) 1 (English High Court).
315 Ibid. at para 78, per Justice Aikens.
316 Ibid.
317 Ibid., at para 79, per Justice Aikens.
318 See, e.g. Articles 18 and 19 of the 2004 UN Convention on Jurisdictional Immunities of States and Their Property. See also the recommendations for parties contracting with states in Dunham and Greenberg, op. cit. fn 303, at pp. 148–149.

10

Investment treaty arbitration

1 Introduction

10.1 In the last decade, investment treaty arbitrations have rapidly increased in number and in significance.[1] As its name suggests, this area of arbitration is based on treaties that enable a foreign investor to claim for loss or damage relating to its investment against a state in which that investment has been made. The three most distinctive features of this form of arbitration in comparison with international commercial arbitration are that:

(i) There is at least one state (or state entity) that is a party to the proceedings, whereas international commercial arbitration does not necessarily involve a state party.[2]

1 Investment treaty arbitration is referred to synonymously as international investment arbitration, foreign investment arbitration, investor-state arbitration or, simply, investment arbitration. Specific texts in this discipline of arbitration include K Yannaca-Small (ed.), *Arbitration under International Investment Agreements: A Guide to the Key Issues*, Oxford University Press, 2010; Z Douglas, *The International Law of Investment Claims*, Cambridge University Press, 2009; C Dugan, D Wallace, N Rubins and B Sabahi, *Investor-State Arbitration*, Oxford University Press, 2008; P Muchlinski, F Ortino and C Schreuer, *The Oxford Handbook of International Investment Law*, Oxford University Press, 2008; R Dolzer and C Schreuer, *Principles of International Investment Law*, Oxford University Press, 2008; N Diamy, *The Resolution of International Investment Disputes: Challenges and Practical Solutions*, Eleven International Publishing, 2008; C McLachlan, L Shore and M Weiniger, *International Investment Arbitration: Substantive Principles*, Oxford University Press, 2007; RD Bishop, J Crawford and WM Reisman, *Foreign Investment Disputes: Cases, Materials, and Commentary*, Kluwer Law International, 2005; N Rubins and NS Kinsella, *International Investment, Political Risk, and Dispute Resolution: A Practitioner's Guide*, Oceana Publications, 2005; and M Sornarajah, *The International Law on Foreign Investment*, 2nd edn, Cambridge University Press, 2004. For collections of relevant awards, reviews or summaries see *ICSID Review – Foreign Investment Law Journal*; *The International Lawyer*; *Journal du Droit International, Clunet*; www.iareporter.com; www.investmentclaims.com; www.investmenttreatynews.org; http://ita.law.uvic.ca; and www.kluwerarbitration.com.

2 However, a large number of arbitrations involving state parties are not, in fact, investment arbitrations. For example, in 2009 78 of the ICC International Court of Arbitration's 817 new cases involved a state or state entity. Moreover, arbitrations involving states are often entirely ad hoc, for example using the UNCITRAL Arbitration Rules, and/or partially administered by the Permanent Court of Arbitration in The Hague. By

(ii) The legal rights invoked generally arise out of treaties and public international law, rather than from domestic law or contracts.
(iii) In the case of ICSID arbitrations, the arbitral process is almost completely delocalised.[3]

10.2 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.

10.3 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. Substantive 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 annulment and enforcement of ICSID awards, respectively, in Sections 8 and 9.

2 International investment law

10.4 The legal framework of modern international investment law has been established primarily through treaties. They take the form of BITs[4] 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:

(i) requiring that the host state treat investors in accordance with international standards; and
(ii) granting foreign investors the right to institute an international arbitration against the host state if these standards are not met.

10.5 Increasingly, transnational 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

comparison, ICSID's total number of new cases for 2009 was 25, i.e. less than half of the ICC's 2009 cases [illegible] for states. It should also be noted that, although rare, arbitrations under investment treaties may be [illegible] state claiming against another state.
3 Delocalisation is explained in Chapter 2, Section 8.
4 See, e.g. the Agreement between the People's Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments, signed on 1 December 2003 and entered into force 11 December 2005.
5 See, e.g. North American Free Trade Agreement, signed 17 December 1992, entered into force 1 January 1994, 32 International Legal Materials 296 and 605; and the Energy Charter Treaty (Annex I to the Final Act of the European Energy Charter Conference), signed 17 December 1994, 34 International Legal Materials 373.

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

The Asia-Pacific region has been associated with a number of significant developments in this area of law.[6] Pakistan was a party to the first bilateral investment treaty (BIT) to be signed.[7] One of the earliest and longest running ICSID cases involved an Asian state.[8] A number of jurisprudentially 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.[9] 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.[10] 10.6

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 2700 BITs now exist.[11] 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.[12]

6 For other Asia-Pacific perspectives on investment arbitration, see John Savage's following publications: J Savage, 'Investment Treaty Arbitration', in M Pryles and M Moser (eds), The Asian Leading Arbitrators' Guide to International Arbitration, JurisNet, 2007, p. 465; J Savage, 'Investment Treaty Arbitration and Asia: Review of Developments in 2005 and 2006', (2007) 3 Asian International Arbitration Journal 1; J Savage, 'Investment Treaty Arbitration and Asia: Survey and Comment', (2005) 1 Asian International Arbitration Journal 3. See also MJ Moser (ed), Investor-State Arbitration – Lessons for Asia, Juris Publishing, 2008 and [illegible] M Mangan and A Feyblatt, 'Investment Treaty Arbitration – An Australian Perspective', (2007) 24 Journal of International Arbitration 133.
7 Treaty for the Promotion and Protection of Investments (with Protocol and exchange of notes) between Pakistan and the Federal Republic of Germany, 457 UNTS 23, signed at Bonn on 25 November 1959 and entered into force on 28 April 1962.
8 Amco Asia Corp v Republic of Indonesia, ICSID Case No. ARB/81/1. The case was registered in 1981 and a final decision in that case (a second annulment decision) was issued in 1992.
9 See International Investment Rule Making: Stocktaking, Challenges and the Way Forward, UNCTAD Series on International Investment Policies for Development (2008), UN Doc. UNCTAD/ITE/IIT/2007/3, at p. 24.
10 See L Nottage and R Weeramantry, 'Investment Arbitration for Japan and Asia: Five Perspectives on Law and Practice', Sydney Centre for International Law, Working Paper No. 21, March 2008, at www.law.usyd.edu.au/scil/WorkingPapers.shtml. Investment claims have been brought against several states from the Asia-Pacific region, including Bangladesh, India, Indonesia, Malaysia, Myanmar, Mongolia, New Zealand, Pakistan, the Philippines, Sri Lanka, Thailand and Vietnam. These claims include those instituted under the ICSID Convention as well as non-ICSID arbitrations. For a list of some of these cases, see Savage, 'Investment Treaty Arbitration' op. cit. fn 6, at p. 477. For a list of cases in which the claimants are from the Asia-Pacific region, see Nottage and Weeramantry, ibid., at Appendix D.
11 See UNCTAD, Recent Developments in International Investment Agreements, International Investment Agreement Monitor No. 3 (2009), UN Doc UNCTAD/WEB/DIAE/IA/2009/8, at p. 2. See also [illegible] 'BIT by BIT: The Growth of Bilateral Investment Treaties and their Impact on Foreign Investment in Developing Countries', (1998) 24 International Lawyer 655; KJ Vandevelde, 'A Brief History of International Investment Agreements', (2005) 12 UC Davis Journal of International Law and Policy 157.
12 UNCTAD, ibid., p. 2.

10.8 As mentioned previously, the first ever BIT signed was the 1959 Pakistan-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.[13] 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.[14] The upturn 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 socialist to free market economies and the rapid economic development of East Asian countries.[15] From an Asian standpoint, the recent growth of BITs has led Dolzer and Schreuer to observe:[16]

> The most significant trends in the evolution of BIT practice in the past decade concerns the negotiation of BITs by Asian states. China has concluded 117 treaties between 1982 and 2006. India concluded its first 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.[17] 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.[18]

10.10 Free trade agreements (FTAs), unlike BITs, are treaties that are not solely dedicated to investment protection. For example, the 2009 Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area[19] (the ASEAN-ANZ Treaty) 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.[20] Combined trade and investment agreements often contain investment protection provisions

13 KJ Vandevelde, 'The Political Economy of a Bilateral Investment Treaty', (1998) 92 *American Journal of International Law* 621, at pp. 627–628.
14 See UNCTAD, *International Investment Rule Making: Stocktaking, Challenges and the Way Forward*, UNCTAD Series on International Investment Policies for Development (2008), UN Doc. UNCTAD/ITE/IIT/2007/3, at p. 23.
15 See Vandevelde, op. cit. fn 13, at p. 628; and UNCTAD, ibid., at p. 15.
16 Dolzer and Schreuer, op. cit. fn 1, pp. 20–21.
17 Ibid., p. 21 (noting that in the past decade more than 600 BITs have been negotiated between developing states).
18 See, e.g. *Maffezini v Spain*, ICSID Case No. ARB/97/7 (Maffezini was an Argentine investor); and *MTD Equity Sdn Bhd & MTD Chile SA v Chile*, ICSID Case No. ARB/01/7 (MTD Equity was a Malaysian investor).
19 Signed on 27 February 2009, but not yet in force.
20 An important multilateral treaty relevant to this region that is entirely devoted to investment protection is the ASEAN Comprehensive Investment Agreement, signed on 26 February 2009 by members of the Association of Southeast Asian Nations (ASEAN). See generally I Maxwell and E-J Wegner, 'The New ASEAN Comprehensive Investment Agreement', (2009) 5(1) *Asian International Arbitration Journal* 167.

similar to those found in BITs.[21] At the end of 2007, 254 of these treaties were in existence and at least 75 more were under negotiation.[22]

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 its 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.[23]

10.12 Several different options may be provided in investment treaty dispute settlement clauses. Article 21(1) of Chapter 11 of the ASEAN-ANZ Treaty contains a good sample of the alternatives:

> A disputing investor may submit a claim . . . at the choice of the disputing investor:
> (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 fora under 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 juridical 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?).[24]

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,

21 See, e.g. Economic Partnership Agreement concluded between Japan and Thailand 2007; Free Trade Agreement between the US and the Republic of Korea 2007; NZ-China Free Trade Agreement 2008; Australia-US Free Trade Agreement 2004; Comprehensive Economic Cooperation Agreement between India and Singapore 2005 and Agreement between Malaysia and Japan for an Economic Partnership 2005. Note that some, such as the Australia-US FTA and the Agreement between Japan and the Republic of the Philippines of an Economic Partnership 2007 do not contain investor-state dispute settlement provisions. An informative compilation of Asian trade and investment treaties is set forth in the Asia Pacific Trade and Investment Agreements Database created by the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP), at www.unescap.org/tid/aptiad/AllAgreementsGrid.aspx (accessed 17 May 2009).
22 UNCTAD, op. cit. fn 14, p. 26.
23 See Section 5.2.1.
24 See McLachlan, Shore and Weiniger, op. cit. fn 1, p. 103, paras 4.73 et seq.

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 administering investment arbitrations between a state (i.e. a government) or state entity and a foreign private investor. ICSID was created as an independent international organisation[26] but it is structurally linked to the World Bank. The bank's governors sit *ex officio* on ICSID's Administrative Council (described below), the Chairman of the Administrative Council is the World Bank's President and the ICSID Secretariat (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, it 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, no case was registered with ICSID[29] and between 1966 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 multi-tiered dispute resolution clauses discussed in Chapter 4, Section 9.4 of this book. Some ICSID tribunals have not required strict compliance with these negotiation periods. See, e.g. *SGS Société Générale de Surveillance SA v Pakistan*, 6 August 2003, 8 ICSID Reports 406, at para 184 and *Bayindir Insaat Turizm Ticaret Ve Sanayi AŞ v Pakistan*, 14 November 2005, at para 100. But see *Generation Ukraine Inc v Ukraine*, 16 September 2003, 10 ICSID Reports 240, at para 14.3.
26 Article 18 of the ICSID Convention states: 'The Centre shall have full international legal personality. The legal capacity of the Centre shall 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 Articles 2, 4, 5; and The World Bank, *A Guide to The World Bank*, 2003, p. 44.
28 See ICSID Convention Article 6; and CH Schreuer, *The ICSID Convention: A Commentary*, Cambridge University Press, 2001, pp. 23–31.
29 *Holiday Inns S.A. v Morocco* (ICSID Case No. ARB/72/1) was the first case to be registered at ICSID on 13 January 1972. It was settled and discontinued on 17 October 1978.
30 See http://icsid.worldbank.org (accessed 23 November 2009) and G van Harten, *Investment Treaty Arbitration and Public Law*, Oxford University Press, 2007, p. 30.

ICSID.[31] Several more investment treaty arbitrations are pending at other arbitral institutions.[32] Two major reasons for this rise in investment treaty arbitration 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

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

> 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 . . .

The key jurisdictional criteria under this provision relate to: 10.19

(i) the nature of the dispute (*ratione materiae*) – it must be legal and arise out of an investment;
(ii) the parties (*ratione personae*) – 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.

Jurisdictional 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. 10.20

4.3 Requirement of an 'investment'

As this book generally indicates, international commercial arbitration may be utilised 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 10.21

31 See http://icsid.worldbank.org (accessed 5 June 2010). The ICSID publication, *The ICSID Caseload – Statistics*, Issue 2010-1, indicates that 19 cases were registered during the fiscal year of 2003, 31 in 2003, 27 in 2004, 27 in 2005, 23 in 2006, 37 in 2007, 21 in 2008, and 25 in 2009. These figures do not include foreign investment arbitrations conducted outside ICSID's auspices. See also van Harten, ibid., pp. 30–31.
32 Two of the other arbitral institutions that administer a number of investment treaty arbitrations are the Stockholm Chamber of Commerce and the ICC International Court of Arbitration. See UNCTAD, *Latest Developments in Investor State Dispute Settlement*, IIA Monitor No. 1, 2009, UN Doc. UNCTAD/WEB/DIAE/IIA/2009/6, p. 2. The non-ICSID investment treaty arbitration figures are uncertain due to their confidential nature.
33 More than 40 investment treaty arbitrations were instituted against Argentina, as a result of the government's response to the Argentine financial crisis of 2000–2001.
34 See generally Chapter 4, Section 8 in this book.

of ICSID arbitrations 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:[35]

> No attempt was made to define the term 'investment' [in the ICSID Convention] given the essential requirement of consent by the parties, and the mechanism through which Contracting States can make known in advance, if they so desire, the classes of disputes which they would or would not consider submitting to the Centre (Article 25(4)).

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 purpose 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.[36] A leading case in this regard is *Salini v Morocco* in which it was said that:[37]

> 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 position was taken in *Malaysian Historical Salvors Sdn Bhd v Malaysia*,[38] which gives importance not to the meaning of 'investment' in Article 25 but to the definition of an investment as found in BITs.[39] 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 *Salini 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.

35 Report of the Executive Directors on the ICSID Convention, 18 March 1965, reprinted in 1 ICSID Reports 28, at para 27. In 1965 the World Bank's name was the International Bank for Reconstruction and Development. See also G Delaume, 'ICSID Arbitration in Practice', (1984) 2 International Tax and Business Lawyer 58, at p. 65.
36 These criteria have been based in large measure on Schreuer's understanding of the meaning of investment. See Schreuer, op. cit. fn 28, p. 140; and Dolzer and Schreuer, op. cit. fn 1, p. 60.
37 Decision on Jurisdiction, 23 July 2001, 6 ICSID Reports 400, at para 52.
38 Decision on the Application for Annulment, 16 April 2009.
39 BITs usually define 'investments' broadly, such as including 'all assets' or 'every kind of investment' in the territory of one contracting party by nationals of another contracting party. In relation to BITs signed by South Asian states, see P Ranjan, 'Definition of Investment in Bilateral Investment Treaties of South Asian Countries and Regulatory Discretion', (2009) 26 Journal of International Arbitration 217.

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.[40] 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 privatized government entities and resources spent to salvage a shipwreck. 10.25

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.[41] In *Gruslin v Malaysia*,[42] the investor claimed under the BIT between Malaysia and the Belgo-Luxemburg 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 authorized as an 'approved project'.[43] 10.26

4.4 Nationality

Nationality is important for ICSID arbitration for two principal reasons. First, pursuant to Article 25(1) 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. 10.27

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.[44] 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. 10.28

The nationality of corporations is usually determined by their place of incorporation or registered office or, alternatively, the effective seat of the business 10.29

40 See, e.g. Fedax N.V. v Venezuela, Decision on Jurisdiction, 11 July 1997, 5 ICSID Reports 186, (1998) 37 International Legal Materials 1378, at para 42.
41 See the examples given in relation to the BITs of Malaysia, Singapore, Pakistan, Indonesia, The Philippines and Thailand in DC Abraham, 'Arbitration of Investment Disputes: A Malaysian Perspective', (2009) 75 Arbitration 206, at pp. 208–209.
42 *Philippe Gruslin v Malaysia*, Final Award, 27 November 2000, 5 ICSID Reports 484.
43 Ibid., at pp. 507–508, para 27.5.
44 See, e.g. *Soufraki v United Arab Emirates*, Award on Jurisdiction, 7 July 2004, 12 ICSID Reports 158.

(*siège social*).[45] Where a BIT provides that the nationality of a company is to be determined by incorporation, arbitral tribunals have generally denied applications to pierce the corporate veil and look at the nationality of its shareholders or ultimate owners.[46] Company shareholders are also usually entitled to institute arbitration proceedings under BITs. Article 25(2)(b) of the ICSID Convention and some BITs also provide that a 'national' of a home state may be a legal entity that is incorporated in the host state but is controlled by nationals of the home state.[47]

10.30 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 *Aguas del Tunari SA v Bolivia*, for example, has said:[48]

> ... it is not uncommon in practice, and – absent a particular limitation – not illegal to locate one's operations in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for examples, of taxation or the substantive law of the jurisdiction, including the availability of a BIT.
>
> ... The language of the definition of national in many BITs evidences that such national routing of investments is entirely in keeping with the purpose of the instruments and the motivations of the state parties.

10.31 Accordingly, the arbitral tribunal rejected Bolivia's contention that the 'migration' 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 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 lacunae exist 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 *LG&E 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 submitted to arbitration. In investment arbitration, agreements submitting present or future disputes to ICSID arbitration concluded directly between the investor and host state are likewise recognised 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 privy 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 legislation[53] or in an investment treaty dispute settlement clause (as discussed above). The investor's consent

45 See generally, A Sinclair, 'The Substance of Nationality Requirements in Investment Treaty Arbitration', (2005) 20 ICSID Review—Foreign Investment Law Journal 357.
46 See, e.g. Tokios Tokelės v Ukraine, Decision on Jurisdiction, 29 April 2004, 11 ICSID Reports 313. This was a rare case in which the president of the arbitral tribunal dissented from the other two arbitrators. The president was in favour of piercing the corporate veil. See also Chapter 4, Section 4.1.1 of this book.
47 See, e.g. *TSA Spectrum de Argentina SA v Argentina*, Award, 19 December 2008, at para 160 ('in the application of the second part of Article 25(2)(b) [of the ICSID Convention] it is necessary to pierce the corporate veil and establish whether or not the domestic company was objectively under foreign control'); and *Aguas del Tunari SA v Bolivia*, Decision on Jurisdiction, 21 October 2005, (2005) 20 ICSID Review – Foreign Investment Law Journal 450, paras 206–323.
48 *Aguas del Tunari*, SA, at paras 330 and 332.

49 See Chapter 3, Section 2.1.
50 This situation may arise, for example, when a claim is brought under a BIT that does not contain a provision on applicable law. In these circumstances, some tribunals have held that arguing the case on the basis of the BIT is conduct that demonstrates that the parties' choice of law is the BIT. See, e.g. *Asian Agricultural Products Ltd v Sri Lanka*, Award, 27 June 1990, 4 ICSID Reports 245, at para 20.
51 See Y Banifatemi and E Gaillard, 'The Meaning of "and" in Article 42(1), Second Sentence, of the Washington Convention: The Role of International Law in the ICSID Choice of Law Process', (2003) 18 ICSID Review—Foreign Investment Law Journal 375; and Dolzer and Schreuer, op. cit. fn 1, pp. 265–271. But see the views expressed in M Reisman, 'The Regime for Lacunae in the ICSID Choice of Law Provision and the Question of its Threshold', (2000) 15 ICSID Review—Foreign Investment Law Journal 362 (submitting, among other points, that the absence of a remedy in the chosen law of a state is not a lacuna: it may be a consequence of a state's decision not to regulate a certain matter and, moreover, the domestic law chosen may itself provide for a method to overcome lacunae).
52 *LG&E Energy Corp v Argentina*, Decision on Liability, 3 October 2006, (2007) 46 International Legal Materials 36, at para 94.
53 For an example of such a domestic law, see Article 8 of Egyptian Law No. 43 that was in dispute in *Southern Pacific Properties (Middle East) Ltd v Egypt*, Decision on Jurisdiction, 3 ICSID Reports 112, at para 70.

is deemed to be provided at a later point in time, namely, through its act of instituting 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 firmly established that an investor can accept a State's offer of ICSID arbitration contained 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 Notice of Arbitration at the ICSID Centre.

10.36 This particular consensual process has famously been described by Jan Paulsson as 'arbitration without privity'.[55]

4.7 Additional facility

10.37 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 authorise the ICSID Secretariat to administer disputes between states and foreign nationals that fall outside the jurisdictional ambit of the ICSID Convention. Often, 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 annulment and enforcement mechanisms (addressed below). The Additional Facility is frequently used to determine 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

10.38 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*, 16 September 2003, 10 ICSID Reports 240, at paras 12.2 and 12.3.
55 J Paulsson, 'Arbitration without Privity', (1995) 10 *ICSID Review – Foreign Investment Law Journal* 232.
56 See Article 2 of the Additional Facility Rules. This Article also permits arbitration or conciliation proceedings to be administered by the ICSID Secretariat in relation to legal disputes that 'do not arise directly out of an investment, provided that either the State party to the dispute or the State whose national is a party to the dispute is a Contracting State . . .'
57 Canada signed the ICSID Convention on 15 December 2006 but has not ratified it. Mexico has not signed the Convention.

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 interference. The architects of the ICSID Convention believed that its arbitration mechanism could provide a safeguard against such risk and enhance the security of foreign investments. 10.39

In addition to providing investors with direct rights 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.[58] 10.40

The advantages of ICSID arbitration include: 10.41

(i) an insulated procedural system that is the most delocalised form of arbitration in the world;[59]
(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.[60] One of the more obvious drawbacks for investors desiring confidentiality is the fact that ICSID awards are usually made public.[61] 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 10.42

58 For a comparison between international commercial arbitration and investment treaty arbitration, see N Blackaby, 'Investment Arbitration and Commercial Arbitration (or the Tale of the Dolphin and the Shark)', in LA Mistelis and JDM Lew (eds), *Pervasive Problems in International Arbitration*, Kluwer Law International, 2006, p. 217.
59 It is far more delocalised than international commercial arbitration between private entities that has been the main subject of this book. For discussion of delocalisation in that context see Chapter 2 Section 5. For instance, it is not possible under any circumstances for a domestic court to set aside an ICSID award or play any role in an ICSID arbitration.
60 For an overview of the disadvantages from a developing state's perspective, see M Sornarajah, 'A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration', in K Sauvant (ed), *Appeals Mechanism in International Investment Disputes*, Oxford University Press, 2008, p. 39.
61 Even though Article 48(5) of the ICSID Convention provides that the 'Centre shall not publish the award without the consent of the parties', in practice, most decisions are made public. Additionally, in 2006, the ICSID Arbitration Rules were amended to require that the centre 'promptly include in its publications excerpts of the legal reasoning of the Tribunal' (Article 48(4)).

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 state A and state 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.[62] There have been a number of instances where arbitral tribunals have not followed prior tribunal interpretations of similar treaty provisions.[63] Some commentators have made strong calls for more consistency in investment treaty arbitral tribunal awards.[64]

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 similar issues 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 annulment 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 resubmitted 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 points. Further, the possibility exists for the award of the new tribunal also to be

62 See G Kaufmann-Kohler, 'Interpretation of Treaties: How do Arbitral Tribunals Interpret Dispute Settlement Provisions Embodied in Investment Treaties?', in Mistelis and Lew, op. cit. fn [illegible], p. [illegible], at p. [illegible]. See also [illegible], 'The Future Role of Past Awards in Investment Treaty Arbitration', ICSID Review – Foreign Investment Law Journal (forthcoming 2010).
63 See, e.g. Lauder v Czech Republic, Final Award, 3 September 2001, 9 ICSID Reports 62; and CME Czech Republic BV v Czech Republic, Partial Award, 13 September 2001, 9 ICSID Reports 121. These were two investment treaty arbitrations brought separately by Mr Lauder in London under the US-Czech Republic BIT and his investment vehicle (CME) in Stockholm under the Netherlands-Czech Republic BIT. The dispute and factual issues were essentially the same in both cases but the outcomes were different. For example, although the two BIT provisions on expropriation were similar, the CME arbitral tribunal held the Czech Republic responsible for expropriation whereas the Lauder arbitral tribunal did not. See also the divergent findings by different arbitral tribunals in relation to Argentina's plea of necessity as a ground to exempt it from liability for its acts during the 1999–2002 Argentine financial crisis in LG&E Energy Corp v Argentina, Decision on Objections to Jurisdiction, 30 April 2004, 11 ICSID Reports 414, at paras 226–261 and CMS Gas Transmission Company v Argentina, Award, 12 May 2005, (2005) 44 International Legal Materials 1205, at paras 353–378. See also CMS Gas Transmission Company v Argentina, Annulment Proceeding, 25 September 2007, at paras 119–136. The SGS cases discussed in Section 6.7 have gained fame for taking different approaches to similar BIT provisions.
64 See, e.g. SD Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions', (2005) 73 Fordham Law Review 1521. See generally E Gaillard and Y Banifatemi (eds), Precedent in International Arbitration, Juris Publishing, 2008.

subject to the annulment process.[65] The length of time to resolve a dispute if all (or even some) of these procedures are invoked may also be inordinate.

5.3 Innovative features

The ICSID Convention introduced a number of innovative features into arbitrations between investors and states. This section will deal with three: the exclusion 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. 10.45

5.3.1 Exclusion of diplomatic protection and investor's direct rights

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 circumvented by the ICSID Convention. The International Court of Justice summarised the difficulties individuals or corporations face under the practice of diplomatic protection in the *Barcelona Traction* case:[66] 10.46

> The Court would here observe 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 natural 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 must 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.

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.[67] 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. 10.47

65 Annulment of ICSID awards is discussed in Section 8 below.
66 Barcelona Traction, Light and Power Company Ltd (Belgium v Spain), Judgment, (1970) ICJ Reports 3, at p. 44, paras 78 and 79. See also Dolzer and Schreuer, op. cit. fn 1, pp. 211–212.
67 If the investor has a contract with a state that includes an arbitration agreement, private commercial arbitration also provides a solution to this problem – the arbitration agreement is considered to constitute an implied waiver of state immunity from suit. See P Dunham and S Greenberg, 'Balancing Sovereignty and the Contractor's Rights in International Construction Arbitration Involving State Entities', (2006) 23(2) International Construction Law Review 130, at p. 147. This is to be contrasted with waiver of immunity from execution. See Section 9 below.

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 has benefits and drawbacks. Courts can offer assistance, for example issuing subpoenas to compel recalcitrant 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 Schreuer 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 58 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 following are examples of domestic court decisions that involve court review of non-ICSID investment treaty arbitral awards: *Czech Republic v CME Czech Republic BV*, Svea Court of Appeal (Sweden) (2003), 9 ICSID Reports 439; and *United Mexican States v Metalclad Corporation*, British Columbia Supreme Court (2001) BCLR (3rd) 359, 5 ICSID Reports 236.
69 Schreuer, op. cit. fn 28, p. 1242.

However, domestic courts may have a role to play in relation to provisional measures in ICSID arbitrations. Rule 39(6) 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. 10.52

5.3.3 Exhaustion of domestic remedies not required

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; it 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: 10.53

> 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 exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.

Although the language of Article 26 permits 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 presents 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] 10.54

6 Substantive rights and protections under investment treaties

This section contains a short overview of the main types of substantive rights or protections that a 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 10.55

70 There may be exceptions to this general position, for example, where a denial of justice is alleged against a state, claimants have been required to show that all legal appeals available in the respondent state were made. See *Loewen v United States*, Award, 26 June 2003, 42 International Legal Materials 840, at paras 142–217. See also the commentary on this decision by R. Wisner[?] in www.investmentclaims.com.
71 Some of the significant advantages of the ICSID system, in comparison with domestic legal systems, is set out in Section 5.1 above.
72 See, e.g. Article 8 of the Agreement between the Government of the Republic of Korea and the Government of the Republic of Argentina on the Promotion and Protection of Investments, signed at Seoul on 17 May 1994 and entered into force on 24 September 1996. Pursuant to Article 8(3) a dispute may be submitted to international arbitration only in the following circumstances:
(a) if one of the parties so requests, where, after a period of eighteen (18) months has elapsed from the moment when the dispute was submitted to the competent tribunal of the Contracting Party in whose territory the investment was made, the said tribunal has not given its final decision, or where the final decision has been made but the parties are still in dispute;
(b) 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 other arbitral awards that have determined similar issues.

10.56 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.[73] A state may also assert certain defences, such as necessity and *force majeure*.[74]

6.1 Expropriation

10.57 International law recognises that a host state may under certain conditions legitimately expropriate foreign property. Investment treaties confirm this position. The legality of the expropriation depends on whether a state's conduct is:[75]

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

10.58 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.

10.59 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, the 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 *Metalclad Corporation v Mexico*, in which the arbitral tribunal observed that expropriation could include:[76]

73 See, e.g. the public international law rules as to attribution codified in Articles 4–11 of the International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts' ('ILC Articles on State Responsibility'), in Report of the International Law Commission on the Work of its Fifty-third Session, UN GAOR, 56th Sess, Supp No. 10, at 43, UN Doc A/56/10 (2001).
74 See, e.g. Articles 23 and 25 of the ILC Articles on State Responsibility.
75 See, e.g. (with slight variations) Article 13(1) of the ASEAN Agreement for the Promotion and Protection of Investments, signed on 15 December 1987, (1988) 27 International Legal Materials 612; Article 4 of the China Model BIT and Article 6 of the US Model BIT. These Model BITs are reproduced in Dolzer and Schreuer, op. cit. fn 1, Annexes 4 and 8.
76 *Metalclad Corporation v Mexico*, Award, 30 August 2000, 5 ICSID Reports 209, at para 103. It is sometimes asserted that this test for indirect expropriation is more lenient than what is referred to as the more 'orthodox' approach. See, e.g. [illegible] Chow, 'Threats, Antidotes and Synthesis: Investor Protection in BITs, WTO and

covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.

Nonetheless, a good deal of debate still exists as to the circumstances that may constitute an unlawful expropriation. Finally, it should be mentioned that in addition to assets, contractual rights may also be expropriated, e.g. the contractual right to develop a housing project.[77] 10.60

6.2 Fair and equitable treatment

Although fair and equitable treatment is a substantive provision found in most investment treaties, it has no authoritative definition. An example of the term is found in Article III of the 1988 Australia-China BIT,[78] which provides that '[a] Contracting Party shall at all times . . . ensure fair and equitable treatment in its own territory to investments and activities associated with such investments'. The content of this type of treatment has tended to evolve over time, particularly through the jurisprudence of investment treaty arbitration awards. The general nature of this provision enables it to be invoked in a broad range of circumstances. One of the most detailed expositions of fair and equitable treatment was articulated in *Tecnicas Medioambientales Tecmed SA v Mexico*:[79] 10.61

> The Arbitral Tribunal considers that this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also

FTAs', (2007) 30 University of New South Wales Law Journal [illegible], at p. [illegible] (the 'orthodox' approach requires a deprivation of the fundamental rights of ownership, [illegible] that the *Metalclad* approach [illegible] requires is that the government measures deprived the investor of a significant part of their anticipated profits, or significantly affected their business plans').
77 See, e.g. *Starrett Housing Corp v Iran*, Interlocutory Award, (1983) 4 Iran-US CTR 122, at pp. 156–157.
78 Agreement between the Government of Australia and the Government of the People's Republic of China on the Reciprocal Encouragement and Protection of Investments, signed and entered into force on 11 July 1988.
79 *Tecnicas Medioambientales Tecmed SA v Mexico*, Award, 29 May 2003, 10 ICSID Reports 130, (2004) 43 International Legal Materials 133, at para 154. See also the test articulated in *Metalclad Corporation v Mexico*, Award, 30 August 2000, 5 ICSID Reports 209, at para 76, in which the tribunal discussed NAFTA's fair and equitable treatment standard by taking into account the references to transparency in Article 102(1) of NAFTA.

expects 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 its investment without the required compensation.

10.62 Some argue that this is a standard that most states would find difficult not to contravene. Generally, however, concepts of legitimate expectations, transparency, predictability, consistency and denial of justice[80] have become prominent criteria 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,[81] which provides 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 protected 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 an 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*.[82] In that case, Sri Lankan government security forces destroyed a shrimp farm during a military operation against rebel forces. Although the arbitral tribunal 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 meaning 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.[83]

6.4 Arbitrary or discriminatory treatment

10.66 To some extent, provisions prohibiting arbitrary or discriminatory treatment may overlap with fair and equitable treatment provisions[84] but most treaties

80 As to the denial of justice and its relation to fair and equitable treatment, see particularly Article 143(2) of the NZ-China Free Trade Agreement, signed on 7 April 2008 and entered into force on 1 October 2008.
81 Bilateral Agreement for the Promotion and Protection of Investments between Cambodia and Malaysia, signed on 17 August 1994.
82 Award, 27 June 1990, 4 ICSID Reports 246, at para 85(B).
83 See, e.g. CME Czech Republic BV v Czech Republic, Partial Award, 13 September 2001, 9 ICSID Reports 121, at para 613, which observed that the amendment of laws or actions of administrative bodies could breach full protection and security standards.
84 Article 143 of the NZ-China Free Trade Agreement (signed 7 April 2008, entered into force 1 October 2008), for example, is headed 'Fair and Equitable Treatment' but it includes an 'unreasonable and discriminatory measures' provision (Article 143(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:[85]

> 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.

In the absence of a definition of 'arbitrary measures' in the relevant BIT, the arbitral tribunal in *Lauder v Czech Republic* relied on the *Black's Law Dictionary* definition of arbitrary: 'depending on individual discretion; . . . founded on prejudice or preference rather than on reason or fact'.[86] 10.67

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 discriminatory under an investment treaty. Local laws may in fact permit discrimination against foreigners but a state cannot rely on its own law to avoid its international obligations.[87] 10.68

6.5 National treatment

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 BIT[88] declares: 10.69

> 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.

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.[89] Case law on this point is not fully settled. On the one hand, the arbitral tribunal in *Feldman v Mexico* narrowed the 'like circumstances' comparative exercise to firms involved in the specific line of business as the claimant.[90] *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.[91] 10.70

85 Agreement between the People's Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments, signed on 1 December 2003 and entered into force on 11 December 2005.
86 *Lauder v Czech Republic*, Final Award, 3 September 2001, 9 ICSID Reports 66, at para 221.
87 Ibid., at para 220.
88 Agreement between the Government of Australia and the Government of the Republic of India on the Promotion and Protection of Investments, signed on 26 February 1999 and entered into force on 4 May 2000.
89 See, e.g. NAFTA, Article 1102.
90 Award, 16 December 2002, 7 ICSID Reports 341, at para 171.
91 Partial Award, 13 November 2000, 8 ICSID Reports 18; 40 International Legal Materials 1408, at para 250.

6.6 Most favoured nation treatment

10.71 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 BIT[92] provides:

> Each Contracting Party shall not in its territory subject investors of the other Contracting Party, as regard their management, use, enjoyment or disposal of investment, 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.

10.72 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.

10.73 It is generally accepted that MFN clauses apply to standards of substantive treatment afforded to investors from third states. For example, in *Bayindir v Pakistan*, the arbitral tribunal used an MFN clause to import a fair and equitable treatment clause in another treaty.[93] In contrast, a good deal of debate has taken place as to whether a MFN clause may also entitle the importation into a treaty of more favourable dispute settlement procedures. The arbitral tribunal in *Maffezini v Spain* triggered the debate when it applied the MFN clause in the Argentina-Spain BIT[94] to import from the Chile-Spain BIT[95] 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.[96] The Argentina-Spain BIT required the claimant to resort to Spain's domestic courts for 18 months prior to instituting proceedings.

10.74 In the opposing camp is *Plama Consortium Ltd v Bulgaria*.[97] The arbitral tribunal in that case held that the MFN provision in the Bulgaria-Cyprus BIT[98] 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-Finland BIT.[99]

10.75 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

92 Agreement between the Government of Malaysia and the Government of the Republic of Indonesia for the Promotion and Protection of Investments, signed on 22 January 1994.
93 *Bayindir Insaat Turizm Ticaret Ve Sanayi AŞ v Pakistan*, Decision on Jurisdiction, 14 November 2005.
94 Acuerdo para la Promoción y Protección Recíproca de Inversiones entre el Reino de España y la República Argentina, signed on 3 October 1991.
95 Acuerdo entre la República de Chile y el Reino de España para la Protección y Fomento Recíprocos de Inversiones, signed on 2 October 1991.
96 This decision was followed by a number of other arbitral tribunals including *Siemens v Argentina AG*, Decision on Jurisdiction, 3 August 2004, 44 *International Legal Materials* 138. See Dolzer and Schreuer, op. cit. fn 1, p. 254.
97 Decision on Jurisdiction, 8 February 2005, 44 *International Legal Materials* 721.
98 Agreement between the Government of the Republic of Cyprus and the Government of the People's Republic of Bulgaria on Mutual Encouragement and Protection of Investments, signed in 1987.
99 Agreement between the Government of the Republic of Finland and the Government of the Republic of Bulgaria on the Promotion and Protection of Investments, signed on 3 October 1997. See also *Telenor v Hungary*, 13 September 2006.

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

6.7 Umbrella clauses

Umbrella clauses are investment treaty provisions that may be described as 'observance of obligations' clauses.[101] A typical example is Article X(2) of the Swiss-Philippines BIT:[102] 10.76

> 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.

Clauses 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] 10.77

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] 10.78

100 See Rubins and Kinsella, op. cit. fn 1, p. 232; and McLachlan, Shore and Weiniger, op. cit. fn 1, p. 237.
101 In a 2006 OECD study, it was suggested that approximately 40% of BITs included an umbrella clause. K Yannaca-Small, 'Interpretation of the Umbrella Clause in Investment Agreements' OECD Working Papers on International Investment, Number 2006/3, available online at www.oecd.org/dataoecd/3/20/37579220.pdf (accessed 16 May 2007), p. 5. This study examines umbrella clauses in the BITs of many of the countries that are the specific focus of this book. In Turner, Mangan and Baykitch, op. cit. fn 6, at p. 119, the interesting observation is made that only four Australian BITs contain umbrella clauses.
102 Agreement between the Swiss Confederation and the Republic of the Philippines on the Promotion and Reciprocal Protection of Investments, signed on 31 March 1997 and entered into force on 23 April 1999.
103 *SGS Société Générale de Surveillance SA v Pakistan*, Decision on Jurisdiction, 6 August 2003, 8 ICSID Reports 406.
104 *SGS Société Générale de Surveillance SA v Philippines*, Decision on Objection to Jurisdiction, 29 January 2004, 8 ICSID Reports 518.
105 The ICSID tribunal added that the umbrella clause, a clause related only to the performance of a state's contractual obligations, not the extent or scope of those obligations. In applying this interpretation to the facts, it held that the determination as to how much money payable by the Philippines to the claimant (i.e. the scope of obligation) was a matter to be determined by the parties only [illegible] investment contract between the claimant and the Philippines). The ICSID tribunal further held that only when this amount was determined would it decide if the Philippines had breached the umbrella clause, i.e. whether it had paid the amount due under the contract (i.e. performed its obligations). The ICSID proceedings were therefore stayed pending the determination of the amount payable. *SGS Société Générale de Surveillance SA v Philippines*, Decision on Objection to Jurisdiction, 29 January 2004, 8 ICSID Reports 518, at paras 126–128 and 174–176. A settlement was agreed between the parties and an award embodying this agreement was rendered on 11 April 2008.
106 See, e.g. Turner, Mangan and Baykitch, op. cit. fn 6, at p. 121; and Rubins and Kinsella, op. cit. fn 1, pp. 237–240.
107 See *MTD Equity Sdn Bhd & MTD Chile SA v Chile*, Award, 25 May 2004, 44 *International Legal Materials*, at para 187.

7 Remedies

7.1 Compensation for expropriation

10.79 A vexed issue in international law has been the identification and application of the standard of compensation for an expropriation. In most investment treaties, the 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 (unlike a lawful expropriation) an 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 McLachlan, Shore and Weiniger, op. cit. fn 1, p. 317, para 9.09.
109 Hull was the US Secretary of State who in 1938 referred to the formula in a series of diplomatic exchanges with the Mexican Ambassador to the US. For the text of these exchanges, see G Hackworth, *Digest of International Law*, US Government Printing Office, 1942, vol. III, pp. 655–661.
110 See, e.g. Dolzer and Schreuer, op. cit. fn 1, p. 91. 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, particularly when lost profits are claimed. Valuation is an area that is beyond the scope of this book. For a detailed discussion of methods of valuation in investment treaty arbitration, see I Marboe, *Calculation of Compensation and Damages in International Investment Law*, Oxford University Press, 2009; and McLachlan, Shore and Weiniger, op. cit. fn 1, p. 319 et seq.
111 It has been observed by Dolzer and Schreuer that damages for an illegal act take into account the subjective position of the victim whereas compensation for a legal act of expropriation is based on an objective standard that takes account of what a hypothetical, willing buyer would normally pay to a willing seller. Dolzer and Schreuer, op. cit. fn 1, p. 274.
112 See, e.g. *Funnekotter v Zimbabwe*, Award, 22 April 2009, para 111; and *Phillips Petroleum Co Iran v Iran* (1989) 21 Iran-US CTR 79, at para 122.
113 *Factory at Chorzów* (Germany v Poland), Merits, (1928) PCIJ Series A, no. 17, p. 47. See also Articles 31 and 36 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*, UNGAOR, 56th Sess., Supp No. 10, at 43, UN Doc. A/56/10 (2001).

> 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.

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] 10.82

7.3 Costs

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 so warranted[116] and, increasingly, arbitral tribunals award costs in favour of the successful party.[117] 10.83

7.4 Interest

Interest is an area in which investment treaty arbitration 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. 10.84

The traditional international law view was expressed in 1943 by Marjorie Whiteman: '[t]here are few rules within the scope of the subject of damages in international law that are better settled than the one 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] 10.85

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

114 *Petrobart Ltd v Kyrgyz Republic*, Award II, 29 March 2005, 13 ICSID Reports 387, at p. 467. See generally Kaj Hobér, 'Compensation: A Closer Look at Cases Awarding Compensation for Violation of the Fair and Equitable Treatment Standard' in Yannaca-Small, op. cit. fn 1, at p. 578 et seq.
115 See McLachlan, Shore and Weiniger, op. cit. fn 1, p. 346, para 9.151.
116 See, e.g. *Generation Ukraine Inc v Ukraine*, Award, 16 September 2003, 10 ICSID Reports 240, para 24.2 et seq where the arbitral tribunal was extremely dissatisfied with the claimant's submissions (e.g. describing the claimant's written presentation of the case as 'convoluted, repetitive, and legally incoherent') and awarded all costs the respondent paid into ICSID as well as a contribution of US$100 000 towards the respondent's legal fees.
117 See, e.g. *ADC v Hungary*, Award, 2 October 2006, at para 531 et seq.
118 MM Whiteman, *Damages in International Law*, Washington, US Department of State, 1943, vol. 3, p. 1997.
119 See, e.g. *RJ Reynolds Tobacco Co v Iran* (1984) 7 Iran-US CTR 181, at pp. 191–192; and *Autopista Concesionada de Venezuela, CA v Venezuela*, Award, 23 September 2003, 10 ICSID Reports 309, para 396.
120 *Compañía del Desarrollo de Santa Elena, SA v Costa Rica*, Award, 17 February 2000, 5 ICSID Reports 153, at para 104.

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 reinvested each year at generally prevailing rates of interest. It is not the purpose of compound interest to attribute blame to, or to punish, anybody for the delay in the payment made to the expropriated owner; it is a mechanism to ensure that the compensation awarded [to] the Claimant is appropriate in the circumstances.

8 Annulment of ICSID awards

10.87 Pursuant to Article 53 of the ICSID Convention, all awards are binding on the parties and are not subject to appeal or other remedies 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 cannot have (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.[121] The ad hoc committee's review is limited to the five narrow grounds listed in Article 52(1):

> Either 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.

10.88 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.[122] The function of the ad hoc committee is not to amend 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.

121 ICSID Convention Article 52(3).
122 The process is therefore considerably longer than annulment procedures of international commercial arbitration awards in sophisticated jurisdictions (for example Singapore or Hong Kong). At the extreme end of prolonged ICSID cases are *Klöckner Industrie-Anlagen GmbH v Cameroon* and *Amco Asia Corp v Indonesia*. They involved annulment procedures and lasted for nine years and 11 years, respectively. See A Redfern, M Hunter, N Blackaby and C Partasides, *Law and Practice of International Commercial Arbitration*, 4th edn, Sweet & Maxwell, 2004, para 9–10 (citing the two mentioned cases but noting that more recently the ICSID annulment mechanism appears to be becoming more efficient).

9 Enforcement of ICSID awards

Article 54 of the ICSID Convention imposes an automatic duty on a contracting state to recognise 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 refusal 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.[123] 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.[124] 10.89

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'. This position is supported by Article 55, which adds: 10.90

> 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'.[125] He continues:[126] 10.91

> 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 enjoin 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 sections demonstrate 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.[127] 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. Notwithstanding 10.92

123 This provision of the New York Convention is discussed in Chapter 9, Section 6.
124 Schreuer, op. cit. fn.28, p. 1124 et seq.
125 Ibid., p. 1144.
126 Ibid.
127 There are exceptions, for example, if an agreement entitles a party to request interim measures from a domestic court pursuant to Rule 39(5) 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 identified as enhancing the effectiveness of the ICSID process is seen to be the reluctance of states to be looked on disfavourably 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.[129]

129 See, e.g. G Born, *International Commercial Arbitration*, Kluwer Law International, 2009, p. 2826, n 7 ('States are often very reluctant to be seen to flout awards made by ICSID tribunals, given the World Bank's importance as a lender'); and E Baldwin, M Kantor and M Nolan, 'Limits to Enforcement of ICSID Awards' (2006) 23 *Journal of International Arbitration* 1, at p. 22 ('the World Bank's Operational Procedures (and the bank's articles of agreement) do not directly address the situation where a member country refuses to honour an ICSID arbitration award. Additionally, the World Bank has not, to the authors' knowledge, spoken publicly about the consequences (if any) for new loans to a Contracting State if that state refused to honour its obligations under the award and the ICSID Convention').

APPENDIX 1

Asia-Pacific arbitral institutions at a glance

The tables in this section provide a basic overview of some arbitral institutions established in or relevant to the Asia-Pacific region.

Australian Centre for International Commercial Arbitration – ACICA	
Website	www.acica.org.au
Where headquartered	Sydney, Australia.
Year established	1985
Administrative structure	ACICA has a Board of Directors, a Secretary-General, and two Deputy Secretaries-General. Decisions made by ACICA are made by the ACICA Board of Directors, or by any person(s) to whom the Board of Directors has delegated decision-making authority.
Current Rules	2005 ACICA Arbitration Rules.
Default appointment process	ACICA appoints arbitrators where a party, or the parties' agreed process, fails. ACICA has no list of arbitrators and may appoint any person it wishes.
Arbitrator challenge adjudication	ACICA determines challenges.
Terms of Reference/Memorandum of Issues	Not specifically required by the rules.
Award scrutiny	Not provided by the rules.
Costs	Arbitrators are paid an agreed hourly rate. Where a rate cannot be agreed ACICA will fix an hourly rate. Non-refundable ACICA registration fee. ACICA administrative fees are calculated as a regressive percentage of the amount in dispute.

ANNEXURE II

Why ISDS is good for Australia

Dr Sam Luttrell
Counsel, Clifford Chance

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 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

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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 *Philip 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 (*Philip 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 managedfrom Perth) operate internationally.

IMPORTANCE OF THE ISDS SYSTEM TO THE INTERNATIONAL RULE OF LAW

One of the less obvious benefit 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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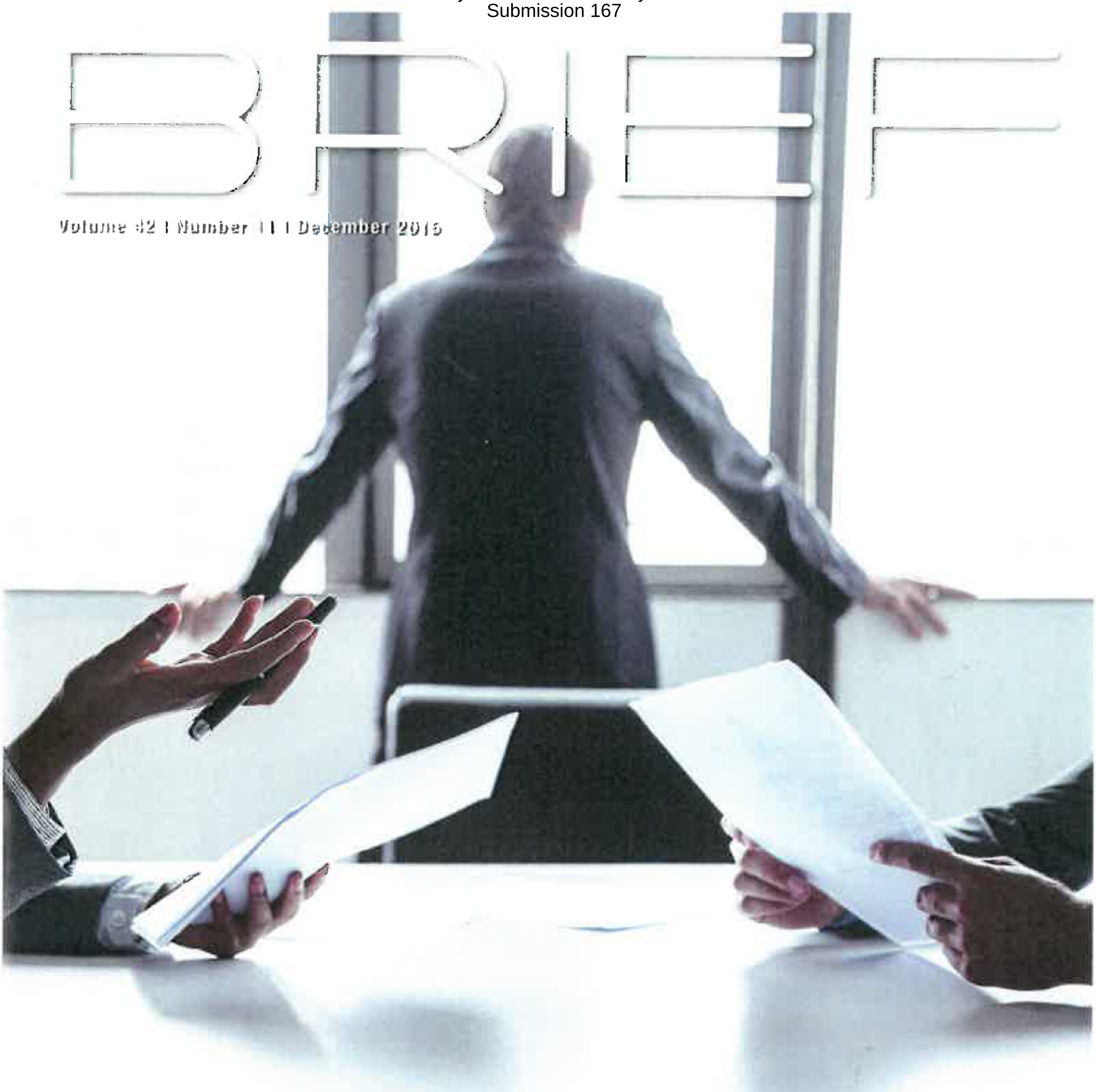

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