



Asia-Pacific
Economic Cooperation

Presentations from the Seminar on
“Current FDI Trends and Investment
Agreements:
Challenges and Opportunities”

Pucón, Chile, 25-26 May 2004



GOBIERNO DE CHILE
DIRECCION GENERAL DE RELACIONES
ECONOMICAS INTERNACIONALES



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Introduction

Being Chile the host economy to the 2004 Asia Pacific Economic Cooperation Forum and as a observer to the Organization of Economic Cooperation and Development, we have converged, for the first time, the efforts of these two relevant instances in the international economic integration and cooperation around the Seminar on “Current FDI and investment agreements: Challenges and opportunities” which was held in the city of Pucón, Chile, the 25th and 26th of May 2004. Organized by the Ministry of Foreign Affairs of Chile, it was sponsored by the Governments of Canada and Japan, as a co-operative initiative on international investment among the APEC Investment Expert Group and the Investment Committee of the OECD.

The convergence of both foras is an important contribution to the discussion of today’s FDI issues. In fact, the OECD has been performing a fundamental and valuable role in the study and formulation of principles and rules for foreign investment and in the case of APEC, it has designed a set of initiatives and actions leading to increase transparency of the regulations on foreign investment. Furthermore, APEC is composed by a dynamic group of economies which have an important role in the world’s capital movements.

Thus seminar convened APEC and OECD Investment delegates, private sector representatives, governmental officials, international investment negotiators, and arbitrators, among many others in order to discuss foreign direct investment trends, disciplines in investment agreements, international investment disputes, as well as to explore future ways of cooperation among both foras regarding investment.

The Seminar addressed a group of subjects which have acquired a high relevance and sensibility in an international juridical level as a consequence of the growing subscription of agreements accorded by our economies, either through a Free Trade Agreement structure or through Bilateral Investment Agreements. Elements such as the transparency principle; the concept and application of the fair and equitable treatment; the relationship between the right to regulate by the State host of the investment and indirect expropriation; the concept and scope of the Most Favored Nation treatment; the evolution registered with respect to investment–State disputes; are all issues which, unavoidably, need a deep study and a comprehensive exchange of ideas, which may contribute to the right application and interpretation of the respective provisions, with the objective of reaching high levels of attraction and protection of foreign direct investment.

For instance, an issue with special sensibility refers to the limits between the regulatory actions that the State develops with respect to any economic sector and the State activities that could be considered as an indirect expropriation. The implications of this determination can be easily seen while analyzing many disputes which have arisen between an investor and the State where the investment is materialized. It could be quite restrictive for the State if this limit appears entering into the sphere of governmental action in areas such as environment, telecommunications, and fisheries, among others. On the other hand, the opposite side could reduce the situations of an

indirect expropriation, damaging the investors' legitimate rights. The capacity to apply in a proper manner the respective rules through the establishment of clear standards is central, and the dialogue that occurred in the Seminar should help in that process.

For Chile, as host economy for this year's APEC meetings and as organizer of this Seminar, this event has a special meaning, given that it represents a valuable step in the policy that our economy has developed with respect to foreign investment and the adoption of international provisions in this field. When we have concluded important trade agreements, containing important rules on investment, it seems more than necessary to promote the exchange of ideas among the investment experts with the purpose to improve the understanding of the rules, standards and principles accorded, and to generate lines of interpretation that lead to their right application.

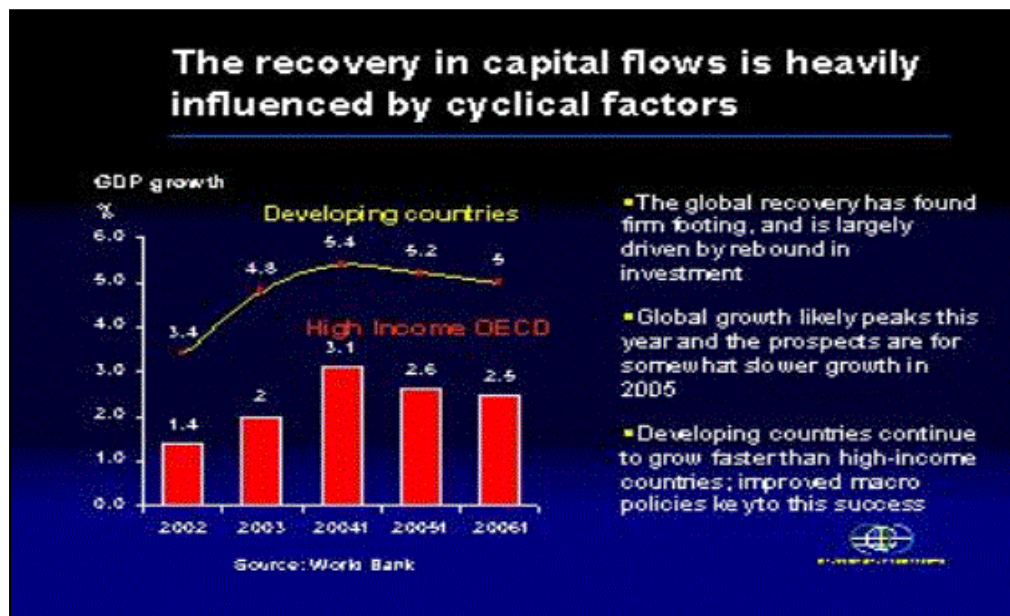
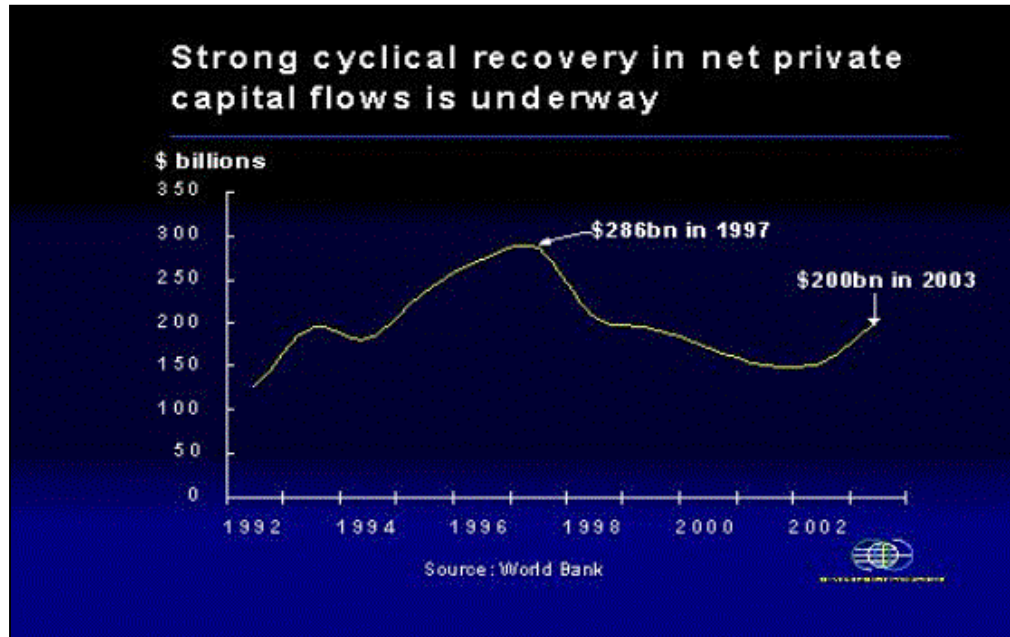
We are certain that these goals were fully achieved and encouraging the realization of similar events in the near future that will allow to continue with the cooperation among foras. This Seminar and the other events to come in the context of the launched cooperation among APEC and OECD in Investment matters, will be an opportunity to share views and create synergies among many of the same interests that both share, contributing to the assessment of promoting investment and maximizing its benefits, which are central to all of our economy's mission in achieving sustainable growth and prosperity.

Global Development Finance in a Cyclical Upturn: Opportunities and Challenges

by

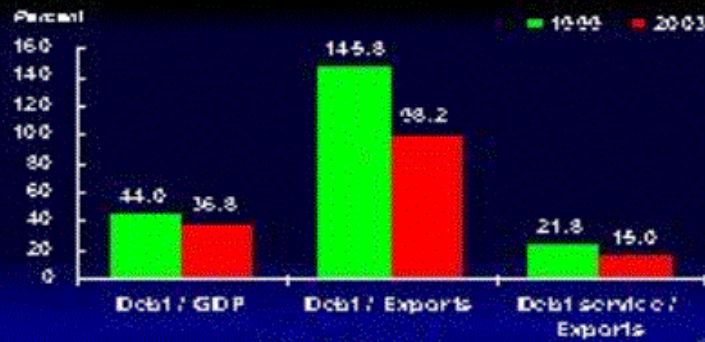
Mr. Fernando Martel García

World Bank



Developing countries' external liability position has improved

Selected debt indicators



Source: World Bank



The Scoop on FDI

- FDI has fallen – primarily to Latin America and Caribbean – but is expected to recover
- FDI is shifting towards services, making it more sensitive to investment climate and political risk
- Service sector FDI is motivated by economic growth, regulatory reform, and technological progress.
- The medium term outlook is good.



FDI flows continued to decline in 2003 but are forecast to rise in 2004-05

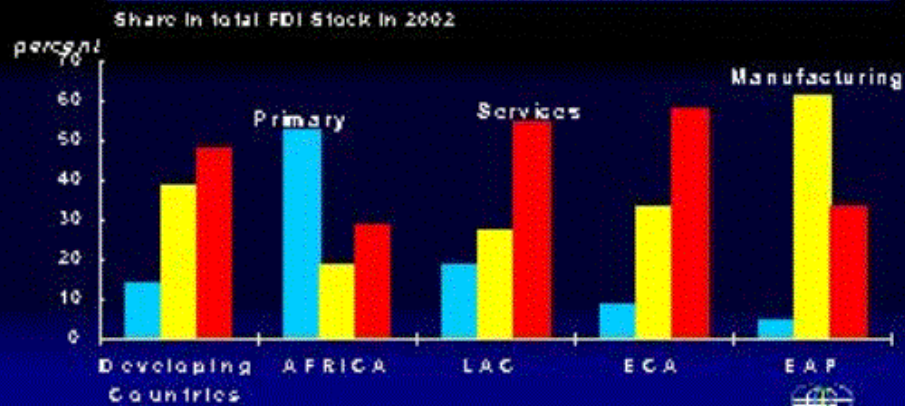
(billions of dollars)	2002	2003e	2004f	2005f
FDI (net)	147	135	152	165
East Asia and the Pacific	56	57	65	74
Europe and Central Asia	33	26	31	32
Latin America and the Caribbean	46	37	38	40
Middle East and North Africa	3	2	2	2
South Asia	4	5	6	7
Sub-Saharan Africa	8	9	10	10

Top 5 Countries in 2003:
China, Mexico, Brazil,
Russia and India

Source: World Bank

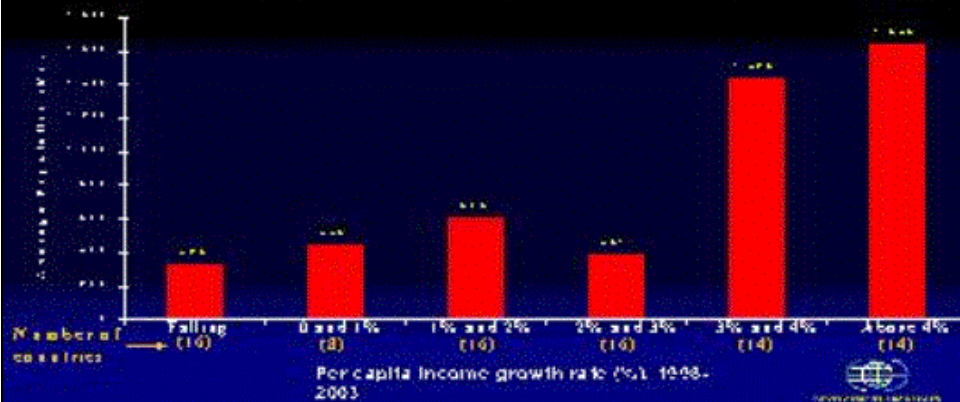


FDI in Services Sector increased in the 1990s...



Source: World Bank, staff estimates

Per capita income growth and population in developing countries (1998 - 2003)



Source: World Bank

Recent Developments in Investment Rules: A Brief Comment

by

Maryse Robert

Principal Trade Specialist, OAS Trade Unit

While investment rules are mostly absent from the multilateral system, the past fifteen years have seen a phenomenal increase in the number of bilateral and regional investment agreements concluded worldwide. Beginning in the late 1980s and early 1990s, numerous developing countries embarked on a series of ambitious economic reforms. They liberalized trade, eased restrictions on foreign investment, and entered into binding obligations to improve their investment climate. In such a context, do policy choices still matter and do investment agreements have a significant impact on foreign direct investment (FDI) flows?

As Mr. Hisashi Michigami pointed out in his presentation, investment agreements have essentially three key pillars: protection, market access, and dispute settlement. The first pillar provides the investor with a minimum standard of treatment and the right to transfer payments in a freely convertible currency (or freely usable currency, as defined by the International Monetary Fund) at the market exchange prevailing on the date of transfer. It also prohibits the host state from directly or indirectly nationalizing or expropriating an investment of an investor of another Party, except when done for a public purpose, on a non-discriminatory basis, in accordance with due process of law, and on payment of compensation (most agreements refer to “prompt, adequate and effective” compensation).

The second pillar adds a market access component to the protection element of a traditional investment agreement. It includes a right of establishment and provides non-discriminatory treatment in all phases of an investment. The second pillar is generally accompanied by a list of negotiated exceptions or reservations (“negative list approach”) but can also be granted “à la carte,” based on a positive list approach as in the General Agreement on Trade in Services (GATS).

As the third pillar, dispute settlement is a central element of an investment agreement. In addition to the general state-to-state dispute settlement mechanism, investment agreements generally include provisions for an investor-state dispute settlement mechanism. The objective of the investor-state dispute settlement mechanism is to depoliticize investment disputes and put them into the sphere of international arbitration. It allows the investor to seek redress against the host state by submitting a claim that the host economy has breached an obligation under the investment agreement and the investor has incurred a loss or damage as a result of the breach. The arbitral tribunal has the authority to award compensation to the injured investor but cannot request the host government to change its laws or regulations.

Traditional investment agreements such as the vast majority of bilateral investment treaties (BITs) include the first and the third pillars, whereas more recent agreements also contain the second pillar. Examples of these newer instruments abound, as Mr. Michigami noted in his presentation. Bilateral investment agreements signed by the United States and Canada, numerous free trade agreements in the Americas and several agreements in Asia such as the Agreement between the Republic of Korea and

Japan for the Liberalization, Promotion and Protection of Investment signed in 2002 do include the three pillars.

While traditional BITs are “enabling in character,” which means that “by themselves, they have little or no effect,” because they do not include a market access component, investment agreements that do include such a component are more likely to have a significant impact on FDI flows when they result in a more liberal investment policy and the opening up of sectors, which had in the past been closed to foreign investors. They may also have a positive influence on FDI inflows by speeding up investment liberalization either before the conclusion of the agreement or during the implementing phase. In the case of regional trade agreements, economic growth generated by these agreements may also encourage higher levels of FDI inflows. Trade barriers, such as stringent and restrictive rules of origin in a free trade area, which discriminate against non-member countries are another important –albeit undesirable from an allocation of resources’ standpoint- factor that may lead to an increase in FDI flows into a region, more specifically tariff-jumping FDI in this case. Firms may wish to switch from exports to FDI in order reap the benefits of the regional market. It is fair to say that all countries do not necessarily benefit equally from a bilateral or regional investment framework. States that choose to restrict access to some of their sectors or industries may not see much increase in FDI inflows. Similarly, countries, which had a fairly open investment regime prior to the entry into force of the agreement, may not experience a surge in FDI flows. In fact, it is difficult to determine *a priori* which countries will benefit the most from a liberalized investment framework because other policy determinants and economic variables play a significant role in explaining any increase in FDI inflows.

Investment agreements are by no means a sufficient condition to attract FDI, albeit they do ensure transparency, predictability, and a degree of legal security to foreign investors. In fact, investment agreements do not negate the ability of countries to enhance their attractiveness to FDI flows by improving their infrastructure (e.g. telecommunications, roads, ports, airports, power), human resources, and technology. These economic determinants play a significant role in encouraging foreign firms to invest in a economy. The signing of investment agreements does not take away the need for economies to be able to exploit their own economy-specific advantages, and, in that regard, policy choices still matter.

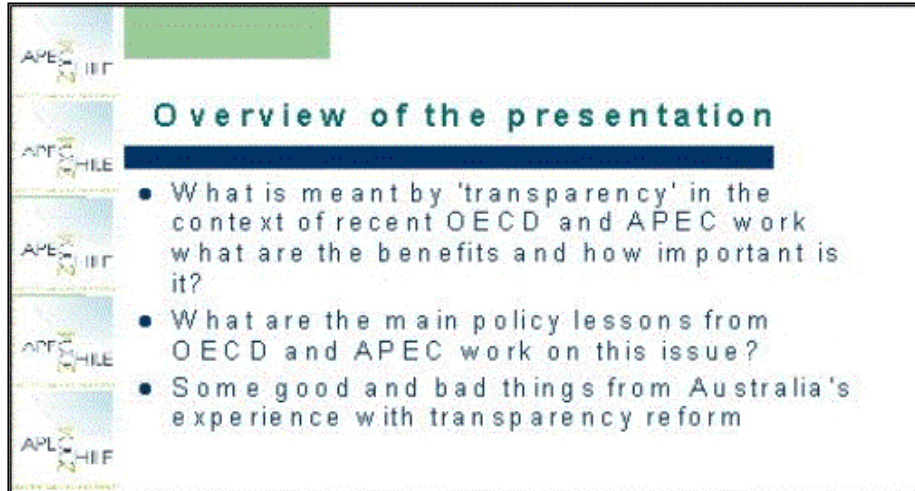
Transparency

by

Mr. Roy Nixon

Foreign Investment Division, Treasury Australia

Good morning. I have been asked to talk this morning about transparency. This is a very large topic and there is no way I can do justice to it in the very short time I have available. So I will have to be specific in my messages



Overview of the presentation

- What is meant by 'transparency' in the context of recent OECD and APEC work what are the benefits and how important is it?
- What are the main policy lessons from OECD and APEC work on this issue?
- Some good and bad things from Australia's experience with transparency reform

I want to spend a few minutes discussing what we mean by transparency, how important is transparency for good governance and what are the benefits. Then I will look at recent work on transparency in both APEC and OECD and suggest some policy lessons we can draw from this work – I note that there is a session tomorrow which will discuss the complementarities and synergies in APEC and OECD co-operation on international investment in more detail.

And finally, I would like to offer some observations on Australia's experience with transparency reform.



Transparency – what does it mean?

- There is no commonly agreed definition of transparency.
- Some concepts of transparency focus on the core measures that promote and protect rights to public sector information.
- A broader view is that transparency is the outcome of successful two-way communication about policy between governments and other interested parties.

Unfortunately for those of you looking for a simple answer, there is no commonly accepted meaning of transparency – it means different things to different groups – be it international organisations like OECD/APEC, foreign investment

regulators and investors themselves. This in part reflects the evolutionary nature of transparency.

APEC, in its transparency standards adopted in 2002 focuses on the role of transparency in the removal of barriers to trade and investment “being in large part only meaningful to the extent that the members of the public know what laws, regulations, procedures and administrative ruling affect their interests, can participate in their development.. and can request review of their application under domestic law...”A broader view is that public sector transparency is fundamentally about effective communication on public policy which requires consideration of national institutions, values, preference and ways of doing things.



The importance that international investors attach to transparency when choosing where to invest has been well documented by business surveys. Lack of transparency and predictability often tops the list of concerns expressed by foreign investors. On the flip side, access to relevant information is often cited as a powerful incentive to invest.

Transparent policy environments, which make information relevant to investors more accessible and user friendly (reduce complexity), offsets what may be foreigners' disadvantages to investing in a host economy i.e. language barriers and more limited knowledge of local institutions.

Recent **OECD and IMF studies** show that international investment flows are higher and that investments tend to be of higher quality in countries with more transparent policy environments. If countries want to attract more and higher quality investment, fostering a fair, open and accountable policy environment is a more efficient way (and involve fewer distortions) than other types of direct incentives – tax holidays etc.

OECD work on public sector transparency

- Trend in OECD countries toward greater transparency.
- Recent OECD regulatory reform survey and report also shows that performance is still far from satisfactory.
- Problems identified include:
 - legal texts difficult to understand;
 - complex regulatory structures; and
 - lack of systematic regulatory impact analysis (RIA)

The OECD has done a considerable amount of very useful work in the area of public sector transparency, and I intend to mention some of this work today. The OECD horizontal project on regulatory reform undertook a survey of transparency measures in the OECD area between 1998 and 2000 (26 countries were surveyed). The synthesis report, which was finalised in 2002, suggested that despite there being signs of progress and a trend toward improved transparency, there is still considerable scope for improving transparency policies and practices. (other data suggests this is also the case for non-OECD countries).

The areas of progress:

- widespread use of consultations
- 18/24 countries had adopted centralised registers of laws and regulations
- ¾ of the countries make most of their primary legislations available on the internet.

The synthesis report also lists the main regulatory transparency problems found in its in-depth regulatory review of 12 countries namely:

- Lack of transparency at regional, state and local levels of government
- public consultation not undertaken systematically when developing new/changing regulations. Also participation biased in public consultations
- inadequate use of communication technologies.

Obstacles to transparency-enhancing reform

- OECD experience indicates that obstacles to reform can be sizable for all countries – developed and less developed.
- Three main obstacles to reform:
 - Politics;
 - Institutions; and
 - Technological, financial and human resources.

While there is widespread agreement on the importance of transparency, OECD experience shows that actually improving transparency in the public sector can be difficult.

The Doha Declaration identifies a role for capacity building to assist developing countries implement new transparency obligations. However, OECD experience suggests that all countries could benefit from assistance because the main obstacle – politics – is an underlying obstacle for all countries. (obviously special need for capacity building in developing countries – resources, human capital etc)

Politics – The main obstacles to transparency-oriented reform are political.

- Attempting to overcome the political dynamic in favour of ‘concentrated benefits’ is an ongoing struggle for all political systems.
- Lack of transparency also shields government officials from accountability. Thus, many actors, both inside and outside the public sector, can have a stake in non-transparent practises.
- Since the actual implementation of reforms are likely to involve painful shifts in the way policies are made and implemented the difficulty is maintaining political momentum for pro-transparency.

Institutions – Since the institutional arrangements in a economy reflect, to some degree, the national culture, history and values of that country, some transparency measures are much more difficult to implement than others. This is why there is no ‘one-size-fits-all’ policy for improving transparency. Instead, the core measures are seen as good starting points for other communication processes that are closely linked to national institutions. It is assumed that the national institutions will evolve gradually to incorporate the transparency measures.

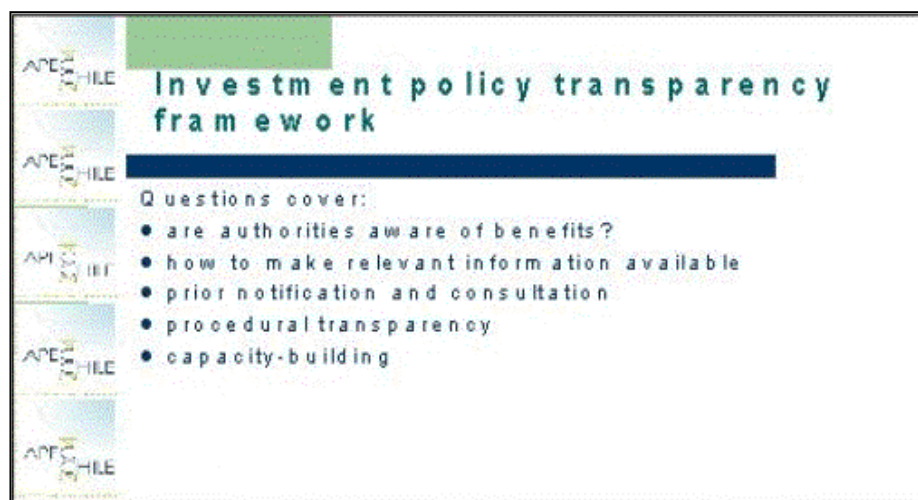
Technological, financial and human resources – Transparency requires resources and entails administrative costs. The core transparency measures involve – the creation of registers, websites, the development of ‘plain language’ texts, and other mechanisms for making legal and regulatory codes, and any changes or new regulations being made, accessible to interested parties.



Underlining the importance of the analytical work done by the OECD to date, and the need for flexibility in country approaches to transparency reform, the OECD has recently developed an Investment Policy Transparency Framework.

The Framework is intended to assist OECD and non-OECD countries enhance their transparency efforts and to share experiences.

It is non-prescriptive in approach. In other words, transparency arrangements reflect national culture, history and values and the availability of resources and skills. Transparency arrangements must adapt to local circumstances to be effective. 15 questions are posed and while there is a strong focus on meeting the special needs of foreign investors (through ensuring the availability of all “relevant” information), the Framework is intended to assist public officials in conducting self-evaluations, will support peer review and can highlight where technical assistance may be required. The Framework also highlights the importance of consolidating domestic transparency into international commitments.

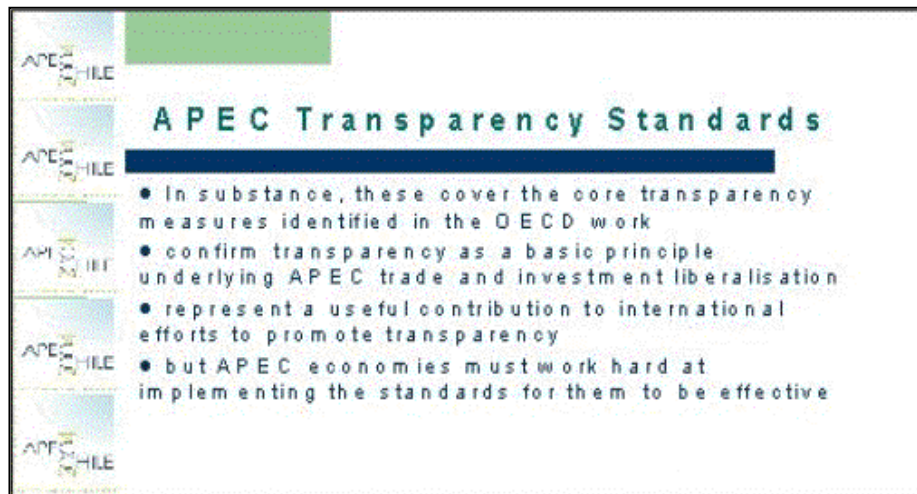


The questions contained in the Framework are practical and cover issues such as:

- 1.To what extent are the authorities aware of the benefits of greater transparency?
- 2.How and what information is made readily available to foreign investors and how was this determined?
- 3.What are the exceptions to making information available?
- 4.How is information kept and how is it presented?
- 5.Are investors consulted in advance about the purpose and nature of regulatory change?
- 6.How are investors assisted in handling “red tape” and what rights of appeal exist to dispute administrative decisions?
- 7.How are capacity bottlenecks being addressed?



Supporting the Investment Policy Transparency Framework is a FDI-focussed and outreach-relevant inventory of transparency measures in the 38 countries which have adhered to the OECD Declaration on International Investment and Multinational Enterprises. This project will cover the three main clusters of issues allegedly at the core of international investment transparency policy, namely *publication and notification*, *prior notification and consultation* and *procedural transparency*.



The APEC Transparency Standards confirm transparency as a basic principle underlying APEC trade and investment liberalisation and facilitation efforts. They encourage each APEC economy to make increased use of Internet to ensure that laws and regulations, and progressively procedures and administrative rulings, of general application are promptly published or otherwise made available and that interested persons and other economies become acquainted with them. Each economy is invited to have or designate an official journal or journals for this purpose. These activities are to be carried out in accordance with the general guidelines for implementing an Individual Action Plan (IAP).

Australian “best practice” on transparency reform

- Mandatory procedures for regulation making and review which covers all legislation and quasi-legislation, involves public consultation, cost-benefit analysis and is subject to independent review
- Searchable online database containing full legal texts and regulations at state and federal level
- Increasing use of "silence is consent" clauses in legislation affecting investment
- Inclusion of transparency commitments in recent FTAs

Like many countries, Australia has some good stories to tell. One of these is the development of best practice processes for regulation making and review directly or indirectly affecting business or restrict competition. The procedures are mandatory, covers all legislation including statutory rules and also quasi-regulation (eg industry codes of practice, guidance notes, accreditation schemes etc) . The rules also apply to international treaties involving regulation. The assessment made involves costs and benefits to government, business (including specifically small business), consumers and the community as a whole. The assessment process is subject to independent review by the Office of regulation review.

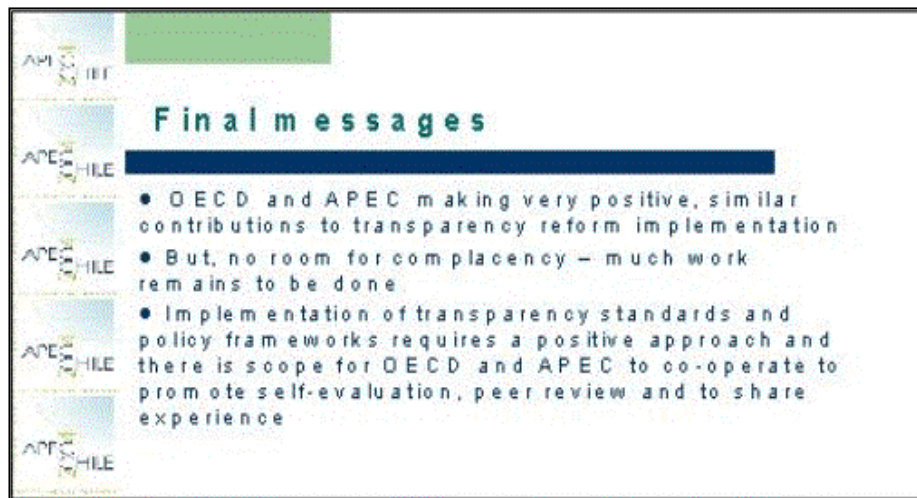
Australia has also developed a legal database covering full legal texts and associated regulations. It covers all levels of government and is fully searchable. There is evidence of increasing use of silence is consent clauses in laws affecting foreign investment, competition law and corporations law. Finally, Australia has included transparency commitments in its recent free trade agreements with Singapore, the US and Thailand.

Possible improvements for Australia in transparency

- Emphasis through promotion agencies to date has been on major project "facilitation" which may not address transparency needs of SMEs.
- More plain language drafting of laws, regulations and also policies and implementation advice including follow-up on quality control by the responsible department.

Australia like many countries has some way to go before it achieves anything like “best practice” in transparency. And for the reasons noted earlier, given Australia’s

history and its institutions, it may take some time to overcome them. Two areas where improvement can be targeted concerns addressing the transparency needs of SMEs – the current federal and state investment promotion effort seems targeted on major (large) investment projects. A second area is a more co-ordinated approach across all levels of government on plain language drafting of laws, regulations, policies and implementation advices – this includes as aspects of quality control during implementation.



In closing my presentation, my sense of transparency is that it is almost universally accepted as a good thing. There is a growing international commitment to promote transparency standards and frameworks and OECD and APEC are at the forefront of this movement.

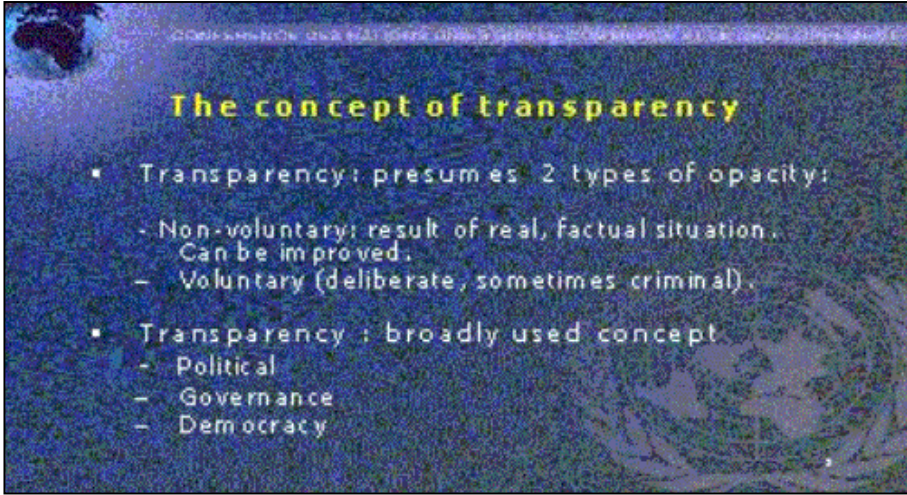
The big enemy is probably complacency – a feeling that once you have a set of standards or a policy framework, the bulk of the work is done.

There needs to be a continuing focus on identifying obstacles to reform, and much of that can come from self-evaluation, from sharing experience (including at useful events such as this seminar) and from allowing others to review your progress.
Thank you.

Transparency in International Investment Agreements

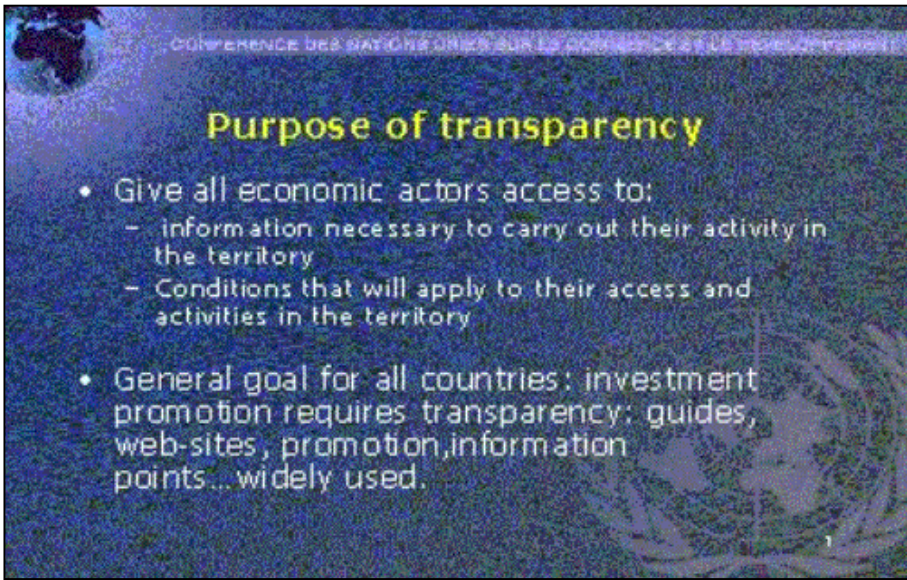
Anna Joubin-Bret

Legal Adviser Division of Investment, Technology and
Enterprise Development, UNCTAD



The concept of transparency

- Transparency: presumes 2 types of opacity:
 - Non-voluntary; result of real, factual situation.
Can be improved.
 - Voluntary (deliberate, sometimes criminal).
- Transparency : broadly used concept
 - Political
 - Governance
 - Democracy



Purpose of transparency

- Give all economic actors access to:
 - information necessary to carry out their activity in the territory
 - Conditions that will apply to their access and activities in the territory
- General goal for all countries: investment promotion requires transparency: guides, web-sites, promotion, information points... widely used.

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Purpose of transparency

- Provide stability and predictability in the investment relationship.
- Enables control and enforcement of reciprocal obligations and commitments and exceptions to such commitments.
- Investment promotion: make information available.
- Contributes to a climate of good governance.
- Allows to assess treatment standards.

CONFERENCE DES NATIONS UNIES SUR LE COMMERCE ET LE DEVELOPPEMENT

Key issues

1. Identify the actors of transparency obligations:
 - Host country
 - Home country
 - Investor
2. Content of the transparency obligation:
 - Degree of intrusiveness of transparency measures into the national legal system.

CONFERENCE DES NATIONS UNIES SUR LE COMMERCE ET LE DEVELOPPEMENT

Key issues (cont.)

3. Modalities for the implementation of transparency obligations:
 - Consultation and exchange of information
 - Making information publicly available
 - Answering request for information
 - Notification requirements
 - Modalities can be voluntarily binding, reciprocal, unilateral, ad hoc or be part of a on-going process.

Key issues (cont.)

4. Timing- Timely implementation of transparency
5. Exceptions and safeguards:
 - National security and defense
 - Legislative or judiciary process
 - Confidentiality of business information

Transparency obligations for the Parties to an IIA

- Rationale: Exchange of information, consultation and notification of lists of exceptions.
Ex : Art. XVI(1) BIT Canada – Thailand [notes]
- Laws and regulations [notes]
 - Ex : Art. II.5 USA BIT Model [notes]
 - EX : Art. XIV BIT Canada-El Salvador (1999)

Transparency obligation for the Parties to an IIA

- BIT Canada : Article XIV
 - « 1. Each Contracting Party shall, to the extent practicable, ensure that its laws, regulations, procedures, and administrative rulings of general application respecting any matter covered by this Agreement are promptly published or otherwise made available in such a manner as to enable interested persons and the other Contracting Party to become acquainted with them.

Obligation for the host country

- Recent developments:

- Ex : Art. 15 Finland BIT Model

- Ex : Art. 2.3 Peru Model BIT (2000) :

7.3. Each Contracting Party shall publicize and disseminate laws and regulations related to investments of investors of the other Contracting Party. Likewise, the Contracting Parties shall exchange information on investment opportunities in their territory in order to increase investment flows.

- Ex : ASEAN Agreement for the Protection and Promotion of Investment:

Provide up-to-date information on all laws and regulations pertaining to foreign investment in its territory.

Transparency on the part of the investor

- In general, no obligation for the investor; he is not a party to the IIAs. He has to abide by the laws and regulations of the host country.
- Klöckner vs. Cameroon case.
- Possibility for the host country to gather information from foreign investors (non-discrimination)
- Free Trade Agreement: Colombia-Venezuela-Mexico (1995): Art. 17-09
- NAFTA (Art. 1111-2): right to require an investor to provide information solely for informational or statistical purposes.

Transparency on the part of the investor

- Hortatory provisions
 - Draft UN Code of Conduct on Transnational Corporations
 - OECD Guidelines on Multinational Enterprises
- Pressure from NGOs: NGO Charter on TNCs
- Voluntary guidelines stemming from business organisations or TNCs.

CONFERENCE DES NATIONS UNIES SUR LE DROIT COMMERCIAL INTERNATIONAL

The content of transparency provisions

- Governmental information:
- Laws and regulations
- Administrative procedures
- Judicial decisions
- International agreements that may affect the operation of the agreement
- Ex : Art. 15.1 - Finland BIT Model [Notes]

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CONFERENCE DES NATIONS UNIES SUR LE DROIT COMMERCIAL INTERNATIONAL

Content of transparency provisions

- In the draft OCDE MAI :

“Each Contracting Party shall promptly publish, or otherwise make publicly available, its laws, regulations, procedures and administrative rulings and judicial decisions of general application as well as international agreements which may affect the operation of the Agreement. Where a Contracting Party establishes policies which are not expressed in laws or regulations or by other means listed in this paragraph but which may affect the operation of the Agreement, that Contracting Party shall promptly publish them or otherwise make them publicly available.”

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CONFERENCE DES NATIONS UNIES SUR LE DROIT COMMERCIAL INTERNATIONAL

Content of transparency provision

- In the WTO agreements :
 - Art. 63 -1 TRIPS : [Notes]
 - Art. III GATS : [Notes]
- Recent developments :
 - Chile - USA FTA : Opens access to « amicus curiae » to the procedure, to submit facts and arguments.

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Content of transparency provisions

- Two remarks:
 - Interpretation of the link to investment. Virtually every measure affects or is relevant to foreign investment: taxation, environment,...
 - Cost of transparency for developing countries.

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Corporate information

- Transparency obligations addressing the investor are often contained in regional establishment agreements.
- Economic community of West African States (Protocol): enterprises admitted to the status of Community Enterprises shall submit progress reports, annual balance sheets and audited accounts...
- Decision 291 of the Cartagena Agreement: information on technology.

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Modalities of implementation

- Making information publicly available
- Ex: Art. II(5) USA Model BIT: (1994)
 - " 5. Each Party shall ensure that its laws, regulations, administrative practices and procedures of general application, and adjudicatory decisions, that pertain to or affect covered investments are promptly published or otherwise made publicly available."

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Modalities of implementation

- 1996 ASEAN Agreement for the Protection and Promotion of Investments – Article III-B
- “Each Contracting Party shall ensure the provision of up-to-date information on all laws and regulations pertaining to foreign investment in its territory and shall take appropriate measures to ensure that such information be made as transparent, timely and publicly accessible as possible”

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Modalities of implementation

- Flexibility :
- Ex : Article 6 – BIT Australia –Laos
- “Each Contracting Party shall, with a view to promoting the understanding of its laws that pertain to or affect investments in its territory by nationals of the other Contracting Party, make, *to the best of its ability*, such laws public and readily accessible.”

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Modalities of implementation

- Answering requests for information :
- Canada-Hungary BIT, Art. X : Upon request by either Contracting Party, information shall be exchanged on the impact that the laws, regulations, decisions, administrative practices or procedures, or policies of the other Contracting Party may have on investments covered by this Agreement
- WTO contact points in each country.
- Flexibility for developing countries (Art. III:4 GATS)

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CONFERENCE DES NATIONS UNIES SUR LE COMMERCE ET LE DEVELOPPEMENT

Notification requirements

- WTO Ministerial decision on notification
 - General obligation to notify the central registry (Council for Trade in Services, WTO secretariat,...)
 - Review from time to time to simplify and standardize notification requirements.
- Most WTO agreements contain this type of obligation.
 - Broad application
 - Notify regularly
 - One-off notification upon entry into force of accession.

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CONFERENCE DES NATIONS UNIES SUR LE COMMERCE ET LE DEVELOPPEMENT

Timing

- Several cases:
 - No reference to timing considerations
 - Promptly, as timely as possible
 - For foreign investors: obligation to submit information on a regular basis (for ex. annually)
 - Ex : OECD Guidelines on Multinational Enterprises: "information should be published within reasonable time limits, on a regular basis, but at least annually."

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CONFERENCE DES NATIONS UNIES SUR LE COMMERCE ET LE DEVELOPPEMENT

Exceptions

- In WTO agreements:
 - Exceptions to the notification requirement in order to protect confidential
 - Possible time limits to implement the transparency commitment.
 - TRIPS : The TRIPS council shall attempt to minimize the burden on Members in carrying out this obligation and may decide to waive the obligation to notify [...]

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CONFERENCE DES NATIONS UNIES SUR LE DROIT INTERNATIONAL ÉCONOMIQUE

Exceptions

- Confidentiality of information submitted by TNCs and investors
- Ex : OCDE Draft MAI – Article III
- [Notes]

23

CONFERENCE DES NATIONS UNIES SUR LE DROIT INTERNATIONAL ÉCONOMIQUE

Transparency and development

- A couple of issues for discussion:
- Content of the transparency provision:
 - Publication :
 - date : before or after entry into force
 - Scope and content: laws, regulations, administrative practices, judicial decisions,...
 - language

24

CONFERENCE DES NATIONS UNIES SUR LE DROIT INTERNATIONAL ÉCONOMIQUE

Transparency and development

- Notification requirements:
 - To other members
 - Prior consultation
- Exceptions :
 - Emergency situation
 - How to administer such exceptions
- Sanctions in case of non-transparency
- Obligation for all actors of the investment triangle: Host State, Home State, investor.

25

Modalities of implementation

- Flexibility :
- Ex : Article 6 – BIT Australia – Laos
"Each Contracting Party shall, with a view to promoting the understanding of its laws that pertain to or affect investments in its territory by nationals of the other Contracting Party, make, *to the best of its ability*, such laws public and readily accessible."

11

Transparency in IIAs

Remark :

Very few IIAs contain specific transparency obligations. But recent trend.

Foreign investors are subject to the laws and regulations of the host country.

12

I – The addressee of transparency obligations

General formulation.

If the addressee is not specified, all parties must comply with transparency obligations.
Reciprocal character of conventional obligations.

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CONFERENCE DES NATIONS UNIES SUR LE COMMERCE ET LE DEVELOPPEMENT

Conclusion

- **Depending on the purpose of the agreement:**
 - Investment protection agreements:
 - Commitment to publish the laws and regulation applicable to the foreign investor
 - Administration of a list of exceptions (negative list) et information of the other contracting party.

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CONFERENCE DES NATIONS UNIES SUR LE COMMERCE ET LE DEVELOPPEMENT

Conclusion

- In liberalization agreements:
 - Information, publication and notification
 - Administration of lists of exceptions or of sectoral commitments
 - Information on the implementation of commitments and non-conforming measures.
- In establishment agreements (regional):
 - Transparency on the part of corporate entities.

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**The International Minimum Standard:
Fair and Equitable Treatment**

by

Michael K. Tracton

Office of Investment Affairs, U.S. Department of State

[Slide 1] It's a pleasure to be here in Pucon this afternoon to present on the topic of "fair and equitable treatment." Before I begin with the substantive portion of my presentation, very briefly, let me remind you of my position with the U.S. Government. I am an investment negotiator with the investment office of the U.S. Department of State, which co-chairs the negotiation of bilateral investment treaties with the Office of the United States Trade Representative, and participates in the negotiation of investment chapters of U.S. free trade agreements. In this role, I've participated in the effort to clarify and refine our model provisions for U.S. investment agreements, including the re-write of the U.S. model BIT. My remarks today draw on these experiences, as well as those of my colleagues at the Department who defend the United States against claims brought in international arbitration pursuant to Chapter Eleven (the investment chapter) of the North American Free Trade Agreement (NAFTA).

The "fair and equitable treatment" obligation is also known as general treatment, or the international minimum standard of treatment, and it is found in international investment agreements around the world, including the NAFTA and other recent free trade agreements entered into by the United States. Unlike the national treatment obligation, and most-favored nation treatment obligation that will be discussed tomorrow, the minimum standard of treatment is an absolute obligation. A Party must provide this level of treatment regardless of the level of treatment it provides to investments of its own investors.

[Slide 2(1)] I will begin by introducing NAFTA's general treatment provision, Article 1105(1). **[Slide 2(2)]** Next, I will explain the NAFTA Parties' interpretation of this provision, **[Slide 2(3)]** and highlight the contrary interpretation that Chapter Eleven claimants have urged NAFTA arbitration tribunals to adopt. **[Slide 2(4)]** I also will explain the role of the NAFTA Free Trade Commission and its interpretation of the general treatment provision. **[Slide 2(5)]** I will conclude by noting steps that the United States has taken to clarify the interpretation of the fair and equitable treatment standard in other recent investment agreements.

The remarks that I make today also describe positions taken by the United States in cases brought against it, and in cases against Canada and Mexico in which the United States has made submissions. **[Slide 3]** I invite you all to take a look at these various submissions, which explore these issues in greater depth than I can do here in this limited time. The submissions are posted on the Department of State's website and can be accessed at www.state.gov/s/l/c3439.htm. Alternatively, you can access many of these materials on the website that is maintained by Mexico's Ministry of Economy at www.economia-snci.gob.mx/sic_php/ls23al.php?s=18&p=1&l=1.
Minimum Standard of Treatment

The general treatment provision in NAFTA's investment chapter is found in Article 1105, which is entitled "Minimum Standard of Treatment."**[Slide 4]** Article 1105(1) requires a NAFTA Party to "accord to investments of investors of another Party

treatment in accordance with international law, including fair and equitable treatment and full protection and security.”

Over the course of several cases involving all three NAFTA Parties, a debate ensued over the scope of the obligation provided for in Article 1105(1). **[Slide 5]** All three NAFTA Parties agreed that the obligation contained in Article 1105(1) was an obligation to accord investments of investors the minimum standard of treatment under customary international law.¹ **[Slide 5(1)]** The “international minimum standard” is a reference to a set of rules regarding the treatment of aliens and their property that over time have crystallized into customary international law.² Customary international law standards may be established by a showing of a general and consistent practice of States followed by them from a sense of legal obligation.³

The three NAFTA Parties also unanimously agreed that the references to “fair and equitable treatment” and “full protection and security” in Article 1105(1) did not expand the Parties’ obligations beyond that provided for in customary international law.⁴ You’ll recall that Article 1105(1) provides that the Parties shall accord investments of investors treatment in accordance with international law, including fair and equitable treatment and full protection and security. The language thus makes clear that “fair and equitable treatment” and “full protection and security” are not obligations that exceed the Party’s obligation under international law but, rather, are concepts to be applied as and to the extent recognized in international law. And, as I mentioned, the three NAFTA Parties all agree that “international law” in Article 1105(1) references customary international law and, specifically, the customary international law minimum standard of treatment of aliens.

[Slide 6(1)] Among the authorities the United States looked to in reaching these conclusions was the OECD Draft Convention on the Protection of Foreign Property, first proposed in 1963 and revised by the OECD Council in 1967. Most scholars trace the use of the phrase “fair and equitable treatment” in international investment agreements back to this Draft Convention.⁵ The commentary to Article 1 of the OECD Draft Convention

¹ See, e.g., *Methanex Corp. v. United States of America*, Memorial on Jurisdiction and Admissibility of Respondent United States of America (Nov. 13, 2000) at 39-43; *Methanex Corp. v. United States of America*, Second Submission of Canada Pursuant to NAFTA Article 1128 (Apr. 30, 2001) at ¶ 26; *Methanex Corp. v. United States of America*, Letter of Mexico Pursuant to NAFTA Article 1128 (May 15, 2001) at ¶ 9.

² See *Methanex v. United States of America*, Memorial on Jurisdiction and Admissibility of Respondent United States of America (Nov. 13, 2000) at 43.

³ See *ADF Group, Inc. v. United States of America*, Rejoinder of Respondent United States of America on Competence and Liability (Mar. 29, 2002) at 31.

⁴ See, e.g., *Methanex Corp. v. United States of America*, Memorial on Jurisdiction and Admissibility of Respondent United States of America (Nov. 13, 2000) at 39-42 & n.53; *Methanex Corp. v. United States of America*, Reply Memorial of Respondent United States of America on Jurisdiction, Admissibility and The Proposed Amendment (Apr. 12, 2001) at 23-27; *Methanex Corp. v. United States of America*, Response of Respondent United States of America to Methanex’s Submission Concerning the NAFTA Free Trade Commission’s July 31, 2001 Interpretation (Oct. 26, 2001) at 6; *Methanex Corp. v. United States of America*, Second Submission of Canada Pursuant to NAFTA Article 1128 (Apr. 30, 2001), at ¶¶ 33, 39; *Methanex Corp. v. United States of America*, Letter of Mexico Pursuant to Article 1128 (May 15, 2001) at ¶¶ 9, 12.

⁵ See UNITED NATIONS CONFERENCE ON TRADE & DEVELOPMENT, BILATERAL INVESTMENT TREATIES IN THE MID-1990S 54 (1998) (“The use of the standard of fair and equitable treatment in BITs dates from the OECD 1967 Draft Convention on the Protection of Foreign Property.”).

provides that the fair and equitable treatment standard “conforms in effect to the ‘minimum standard’ which forms part of customary international law.”⁶ [Slide 6(2)] More than fifteen years later, in 1984, the OECD’s Committee on International Investment and Multinational Enterprises surveyed the OECD member States on the meaning of the phrase “fair and equitable treatment.” The committee confirmed that the member countries continued to view the phrase “fair and equitable treatment” as a reference to principles of customary international law.⁷

[Slide 6(3)] The phrase “fair and equitable treatment” also appears in the general treatment provision in a series of bilateral investment treaties that the United States has negotiated with numerous countries. When the United States submitted those treaties to the United States’ Senate for advice and consent, in its submittal letters, it noted that the general treatment provision incorporated a minimum standard of treatment based in customary international law.⁸

Many of the claimants who have filed cases under NAFTA's investment chapter have urged tribunals to adopt contrary interpretations. These claimants have argued that Article 1105(1) requires the NAFTA Parties to provide more than the minimum standard of treatment for aliens under customary international law.⁹ [Slide 7] They claim that the

⁶ OECD, 1967 Draft Convention on the Protection of Foreign Property, *reprinted in* 7 I.L.M. 117, 120 (1968).

⁷ OECD, Committee on International Investment & Multinational Enterprises, Intergovernmental Agreements Relating to Investment in Developing Countries, ¶ 36 at 12, Doc. No. 84/14 (May 27, 1984) (“According to all Member countries which have commented on this point, fair and equitable treatment introduced a substantive legal standard referring to general principles of international law even if this is not explicitly stated . . .”). *See also* UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS & INT’L CHAMBER OF COMMERCE, BILATERAL INVESTMENT TREATIES 1959-1991 at 9 (1992) (“fair and equitable treatment . . . is a general standard of treatment that has been developed under customary international law.”).

⁸ *See, e.g.*, Dep’t of State, Letter of Submittal for U.S.-Armenia Treaty Concerning the Reciprocal Encouragement and Protection of Investment, Sept. 23, 1992, *reprinted in*, S. Treaty Doc. 103-11 at viii (1993) (provisions addressing “fair and equitable treatment” and “full protection and security” “set[] out a minimum standard of treatment based on customary international law”); *accord* Dep’t of State, Letter of Submittal for U.S.-Ecuador Treaty Concerning the Encouragement and Reciprocal Protection in Investment, Aug. 27, 1993, *reprinted in* S. Treaty Doc. 103-15 at ix (1993); Dep’t of State, Letter of Submittal for U.S.-Estonia Treaty Concerning the Encouragement and Reciprocal Protection in Investment, Apr. 19, 1994, *reprinted in* S. Treaty Doc. 103-38 at ix (1994); Dep’t of State, Letter of Submittal for U.S.-Georgia, Treaty Concerning the Encouragement and Reciprocal Protection in Investment, Mar. 7, 1994, *reprinted in* S. Treaty Doc. 104-13 at viii-ix (1995); Dep’t of State, Letter of Submittal for U.S.-Jamaica Treaty Concerning the Encouragement and Reciprocal Protection in Investment, Feb. 4, 1994, *reprinted in* S. Treaty Doc. 103-35 at viii (1994); Dep’t of State, Letter of Submittal for U.S.-Moldova Treaty Concerning the Encouragement and Reciprocal Protection of Investment, Apr. 21, 1993, *reprinted in*, S. Treaty Doc. 103-14 at ix (1993); Dep’t of State, Letter of Submittal for U.S.-Mongolia Treaty Concerning the Encouragement and Reciprocal Protection in Investment, Oct. 6, 1994, *reprinted in* S. Treaty Doc. 104-10 at viii (1995); Dep’t of State, Letter of Submittal for U.S.-Trinidad & Tobago Treaty Concerning the Encouragement and Reciprocal Protection in Investment, Sept. 26, 1994, *reprinted in* S. Treaty Doc. 104-14 at viii-ix (1995); Dep’t of State, Letter of Submittal for U.S.-Ukraine Treaty Concerning the Encouragement and Reciprocal Protection of Investment, Mar. 4, 1994, *reprinted in*, S. Treaty Doc. 103-37 at ix (1994); Dep’t of State, Letter of Submittal for U.S.-Uzbekistan, Treaty Concerning the Encouragement and Reciprocal Protection in Investment, Dec. 16, 1994, *reprinted in* S. Treaty Doc. 104-25 at viii (1996).

⁹ *See, e.g.*, *Methanex Corp. v. United States of America*, Claimant Methanex Corporation’s Counter-Memorial on Jurisdiction (Feb. 12, 2001) at 8-11 & n.4; *Methanex Corp. v. United States of America*, Claimant Methanex Corporation’s Rejoinder to the United States’ Reply Memorial on Jurisdiction, Admissibility and the Proposed Amendment (May 25, 2001) at 33-35; *ADF Group, Inc. v. United States of America*, Memorial of the Investor (Aug. 1, 2001) at ¶¶ 221-228, 238, 243.

reference in Article 1105(1) to “international law” encompasses all of international law, and not just customary international law. Thus, according to these claimants, all of the conventional treaty obligations that a NAFTA Party has entered into are incorporated into that Article.¹⁰ For example, these claimants assert that this Article incorporates WTO obligations that could not otherwise be thought of as customary international law obligations – such as phytosanitary obligations or transparency obligations.

In addition, they argue that the term “fair and equitable treatment” is a standard to be applied without reference to customary international law.¹¹ According to these claimants, a tribunal need only decide whether it deems the action challenged by the claimant to be “unfair” or “inequitable.”¹² If it determines that it is, these claimants contend that such a finding is sufficient to establish a violation of Article 1105(1). One claimant has even gone so far as to suggest that the standard to be applied under Article 1105(1) is “Does it bother you?”¹³ If a tribunal finds that the challenged action does, indeed, “bother” it, then, according to this claimant, it may find a breach of Article 1105(1).¹⁴ Needless to say, the United States, along with Canada and Mexico, strongly disagrees with this approach.

[Slide 8] In support of their contrary conclusion regarding the scope of Article 1105(1), claimants relied primarily on writings of publicists. In particular, claimants placed heavy emphasis on an article written by F.A. Mann published in the *British Yearbook of International Law* in 1981.¹⁵ In that article, Mr. Mann opined that the obligation to provide “fair and equitable treatment” goes beyond the obligation to provide aliens with the minimum standard of treatment under customary international law.¹⁶

Several decisions by tribunals under NAFTA Chapter Eleven addressed the general treatment provision prior to the issuance of the Free Trade Commission’s interpretation of NAFTA Article 1105(1), which I’ll turn to next.**[Slide 9]** In these cases, claimants made – and in some cases tribunals adopted – the erroneous interpretation of the general treatment provision described above. These cases include *Metalclad v. Mexico*, *S.D. Myers v. Canada*, and *Pope & Talbot v. Canada*. Because of their shared consensus that the general treatment provision refers only to the minimum standard of

¹⁰ See, e.g., *id.*

¹¹ See, e.g., *id.*

¹² See, e.g., *Methanex Corp. v. United States of America*, Claimant Methanex Corporation’s Submission in Response to the NAFTA Free Trade Commission Interpretation of July 31, 2001 (Sept. 18, 2001) at 3 (Article 1105 requires [the Tribunal] to determine, based on all the relevant facts and circumstances, whether the United States and the State of California treated Methanex and its investors fairly and equitably”); *ADF Group, Inc. v. United States of America*, Memorial of Investor (Aug. 1, 2001) at ¶ 243 (“the Tribunal need only look at the treatment and determine itself whether or not such treatment – on its own – is in itself ‘fair’ and ‘equitable.’”).

¹³ *ADF Group, Inc. v. United States of America*, Transcript of Proceedings (Apr. 16, 2002) at 203-04. See also *id.* at 529-532 (containing U.S. response).

¹⁴ See *id.*

¹⁵ F.A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52 *Brit. Y.B. Int’l L.* 241 (1981).

¹⁶ *Id.* at 244 (“The terms ‘fair and equitable treatment’ envisage conduct which goes far beyond the minimum standard and afford protection to a greater extent and according to a much more objective standard than any previously employed form of words. A tribunal . . . will have to decide whether in all the circumstances the conduct in issue is fair and equitable or unfair and inequitable. . . . The terms are to be understood and applied independently and autonomously.”).

treatment under customary international law, the United States and its NAFTA partners viewed these interpretations with concern.

Free Trade Commission Interpretation

[Slide 10] On July 31, 2001, the NAFTA Free Trade Commission issued an authoritative interpretation of Article 1105(1).¹⁷ The Free Trade Commission is comprised of the trade ministers of the three NAFTA countries. [Slide 10(2)] Article 2001(2) of the NAFTA provides that the Commission shall, among other things, “resolve disputes that may arise regarding [the Agreement’s] interpretation or application.” [Slide 10(3)] Article 1131(2) of the NAFTA provides that “[a]n interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under [Section B of Chapter Eleven].”

On July 31, 2001, the Free Trade Commission issued an interpretation of certain provisions of the NAFTA. In its interpretation of the minimum standard of treatment article, the Free Trade Commission stated that Article 1105(1) prescribes exactly what the NAFTA Parties had unanimously been telling tribunals that it does. [Slide 11] The FTC Interpretation provides, in pertinent part, that:

B. Minimum Standard of Treatment in Accordance with International Law

1. Article 1105 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
2. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).¹⁸

¹⁷ See also RUDOLPH DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* 59 (1995) (“Some debate has taken place over whether reference to fair and equitable treatment is tantamount to the minimum standard required by international law or whether the principle represents an independent, self-contained concept.”); UNITED NATIONS CONFERENCE ON TRADE & DEVELOPMENT, *BILATERAL INVESTMENT TREATIES IN THE MID-1990S* 53-54 (noting debate); UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS, *KEY CONCEPTS IN INTERNATIONAL INVESTMENT ARRANGEMENTS & THEIR RELEVANCE TO NEGOTIATIONS ON INTERNATIONAL TRANSACTIONS IN SERVICES* 12 (1990) (same); Stephen Vasciannie, *The Fair and Equitable Treatment Standard in International Investment Law and Practice*, 70 *Brit. Y.B. Int’l L.* 99, 102-04 (1999) (“At least two different views have been advanced as the precise meaning of the term ‘fair and equitable treatment’ in investment relations. One possible approach is that the term is to be given its plain meaning The second approach to the meaning of the term suggests that fair and equitable treatment is synonymous with the international minimum standard in international law.”).

¹⁸ The July 31, 2001 FTC Interpretation is available at <<http://www.state.gov/s/l/c3439.htm>>. For further background on the issue of the interpretation of the minimum standard of treatment provision, see Andrea J. Menaker, *Standards of Treatment in Investment Agreements Signed by the APEC Economies: National Treatment, Most Favored Nation Treatment and the Minimum Standard of Treatment* (2001) (published by the Ministry of Economy, Mexico, for the APEC Secretariat); J.C. Thomas, “Reflection on Article 1105 of

[Slide 12] Paragraph one of the interpretation makes clear that the minimum standard of treatment in Article 1105(1) is, in fact, a reference to the customary international law minimum standard of treatment of aliens. It rejects the view that Article 1105's reference to treatment in accordance with international law refers to *all* international law, including conventional law. Rather, as the NAFTA Parties have consistently contended, the standard of treatment to be afforded to investments of investors is that of *customary* international law.

[Slide 13] Paragraph two of the interpretation confirms that the phrases "fair and equitable treatment" and "full protection and security" are to be applied only insofar as those terms are understood as part of the customary international law minimum standard of treatment of aliens. The interpretation thus rejects claimants' position that those terms are to be applied without regard to customary international law. In particular, the interpretation makes clear that tribunals may only find a violation of Article 1105(1) if the claimant has identified a rule of customary international law that has been breached by the NAFTA Party. A tribunal may not predicate a finding of a violation on its determination that the NAFTA Party has acted "unfairly" or "inequitably" based on the arbitrator's own subjective notions of those terms.

[Slide 14] Like the first paragraph of the interpretation, the third paragraph clarifies that Article 1105's reference to "international law" is a reference to the customary international law minimum standard of treatment, and is not a reference to the entirety of international law. Thus, the third paragraph explicitly provides that a claimant's establishment of a violation of a conventional international obligation does not establish a violation of Article 1105(1). This aspect of the interpretation clearly rejects the *Metalclad* tribunal's approach of basing a violation of Article 1105(1) on a finding of a violation of transparency-related obligations that were not shown to be a customary international legal obligation. It also indicates that arguments by Canadian claimant Methanex, for example, that Article 1105(1) is violated whenever it can be established that a NAFTA Party has failed to adopt the least trade restrictive measure to achieve its objective should also be rejected.¹⁹ That concept is derived from WTO jurisprudence and is a conventional treaty obligation. In the United States' view, the least trade restrictive principle is not a customary international law obligation, and no such requirement is therefore embodied in Article 1105(1).²⁰

In the four NAFTA decisions to address the standard of fair and equitable treatment following the FTC's July 2001 interpretation of Article 1105(1), each tribunal has reached conclusions consistent with the view that fair and equitable treatment is a reference to the customary international law minimum standard of treatment. **[Slide 15]** These cases are *Mondev International v. U.S.*, *UPS v. Canada*, *ADF Group v. U.S.*, and *Loewen v. U.S.* Again, you can read the details of these cases on the websites that I listed earlier.

NAFTA: History, State Practice and the Influence of Commentators," *ICSID Review – Foreign Investment Law Journal* (2002) 17(1) pp. 21-101.

¹⁹ See, e.g., *Methanex Corp. v. United States of America*, Claimant Methanex Corporation's Rejoinder to United States' Reply Memorial on Jurisdiction, Admissibility and the Proposed Amendment (May 25, 2001) at 56-57.

²⁰ See *Methanex Corp. v. United States of America*, Rejoinder Memorial of Respondent United States of America on Jurisdiction, Admissibility and the Proposed Amendment (June 27, 2001) at 34-39.

Clarification of Standards

To avoid the possibility that tribunals established under its new investment agreements will misinterpret the general treatment provisions, the United States has clarified the meaning of this standard in its most recent investment agreements. Specifically, the United States incorporated the July 2001 NAFTA FTC Interpretation of the minimum standard of treatment into the corresponding provisions in its Free Trade Agreements with Singapore and Chile, which both entered into force on January 1, 2004. [Slide 16] Article 10.4 of the U.S.-Chile Free Trade Agreement imposes the minimum standard treatment obligation in paragraph 1. For clarity, the word "customary" is added. [Slide 17] It goes on to set forth provisions that restate the FTC interpretation in detail:

2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights....

The provision further elaborates on this customary international law standard:

The obligation in paragraph 1 to provide:

(a) "fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and

(b) "full protection and security" requires each Party to provide the level of police protection required under customary international law.

Finally, as in the NAFTA interpretation, this provision provides:

3. A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this Article. "

²¹ [Slide 18]

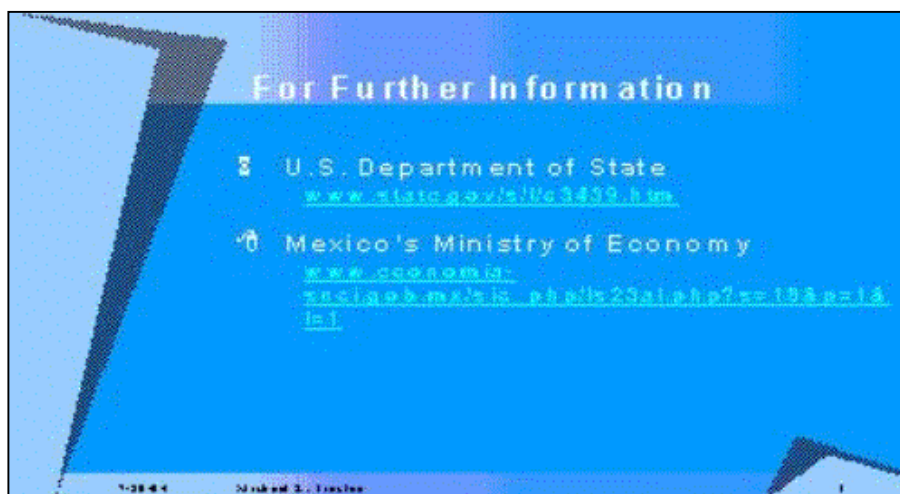
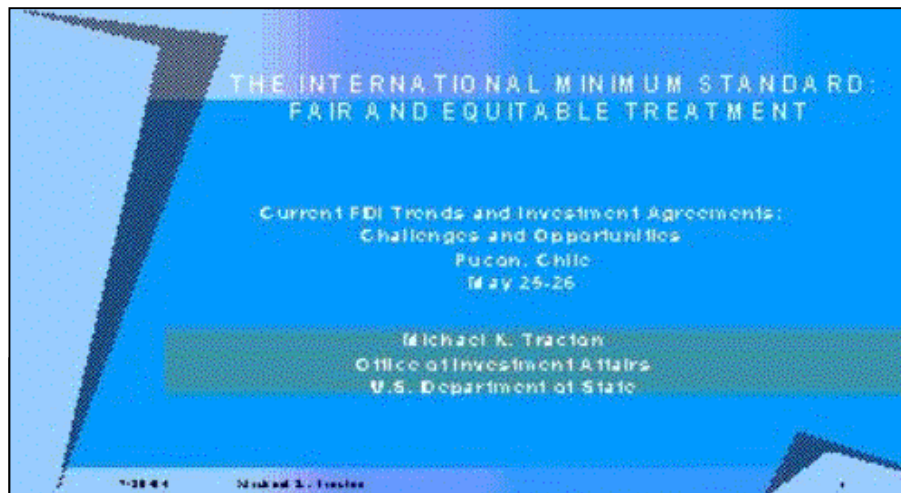
The United States has also incorporated this language in its recent FTAs with Central American countries, Morocco, and Australia, and into its draft improved model bilateral investment treaty.²²

* * *

²¹ See, e.g., U.S.-Chile Free Trade Agreement, Art. 10.4(2).

²² 2004 Draft Updated Model Bilateral Investment Treaty, Draft Article 5.2, available at <http://www.state.gov/e/eb/rls/prsr/28923.htm>. The objective of the model BIT rewrite generally is to provide a consistent approach between the investment chapters of U.S. free trade agreements and future U.S. BITs. The State Department and USTR have been consulting their respective advisory committees and the relevant congressional committees on the draft text since late 2003 and intend to finalize the new model text in the near future. These consultations may result in further changes to the text.

That concludes my discussion today on the minimum standard of treatment found in the NAFTA's investment chapter. I hope that you've found these remarks useful. Thank you.



Article 1105: Minimum Standard of Treatment

(1) Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

7-26-04

Michael S. Foster

4

Scope of Article 1105(1)

- ◆ Customary International Law Obligations – **Yes!**
- ◆ All International Law Obligations – **No!**

7-26-04

Michael S. Foster

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Basis for U.S. Interpretation

- ◆ OECD Draft Convention on the Protection of Foreign Property, 1963 and 1967
- ◆ OECD Committee on International Investment and Multinational Enterprises Survey, 1984
- ◆ U.S. Bilateral Investment Treaties
- ◆ Canadian Statement of Implementation of the NAFTA, 1994

7-26-04

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Scope of Article 1105(1)

- ◆ Customary International Law Obligations – **Yes!**
- ◆ All International Law Obligations – **No!**

7-24-04

Michael C. Toner

Basis for Claimants' Interpretation

- ◆ Writings of publicists
 - F.A. Mann's 1981 British Yearbook of International Law article

7-24-04

Michael C. Toner

NAFTA Tribunal Decisions

- ◆ *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB (AF)97/11 (Award) (Aug. 30, 2000)
- ◆ *S.D. Myers v. Canada* (Partial Award) (Nov. 13, 2000)
- ◆ *Pope & Talbot, Inc. v. Canada* (Award) (Apr. 10, 2001)
- ◆ *United Mexican States v. Metalclad Corp.*, Supreme Court of British Columbia, 2001 BSCS 664 (May 2, 2001)

7-28-04

Michael C. Toner

NAFTA Free Trade Commission

- ◆ The trade ministers of the three NAFTA countries
- ◆ Article 2001(2): The FTC shall "resolve disputes that may arise regarding [the Agreement's] interpretation or application."
- ◆ Article 1131(2): "An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under [Section B of Chapter Eleven]."

1-28-04

Michael S. Foster

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FTC Interpretation, July 2001

B. Minimum Standard of Treatment in Accordance with International Law

1. Article 1105 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
2. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).

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FTC Interpretation, July 2001

"Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party."

FTC Interpretation of July 31, 2001 ¶ B(1)

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FTC Interpretation, July 2001

"The concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens."

FTC Interpretation of July 31, 2001 ¶ B(2)

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FTC Interpretation, July 2001

"A breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1)."

FTC Interpretation of July 31, 2001 ¶ B(3)

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Cases Decided after the FTC Interpretation of Article 1105(1)

- *Mondex International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2 (Award) (Oct. 11, 2002)
- *United Parcel Service of America Inc. ("UPS") v. Canada*, (Award on Jurisdiction) (Nov. 22, 2002)
- *ADF Group Inc. v. United States of America*, ICSID Case No. ARB(AF)/00/1 (Award) (Jan. 9, 2003)
- *Loewen Group, Inc. v. United States*, ICSID Case No. ARB(AF)/98/3 (Final Award) (June 26, 2003)

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Incorporation of Clarification

U.S.-Chile Free Trade Agreement, Article 10.4(1)

1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.

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Incorporation of Clarification

U.S.-Chile Free Trade Agreement, Article 10.4(2) & (3)

*2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:

(a) "fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and

(b) "full protection and security" requires each Party to provide the level of police protection required under customary international law.

3. A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this Article.

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Conclusions

→ Clarification of Standards

- U.S.-Singapore FTA
 - Available at <http://www.usisf.com/en/US/Singapore.html>
- U.S.-Chile FTA
 - Available at <http://www.usisf.com/en/US/Chile.html>
- U.S. Draft Model Bilateral Investment Treaty
 - Available at <http://www.usisf.com/en/US/BIT.html>

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Comments to the Speech of Mr. Michael K. Tracton on International Minimum Standard: Fair and Equitable Treatment

by

Carlos A. Herrera

Proinversión, Government of Peru

It's a pleasure to be here in Pucon to comment the interesting presentation made by Mr. Tracton on the topic of "fair and equitable treatment." It is also a pleasure for me to meet again my colleagues from the Investment Expert Group. I want to thank my Chilean friends and the organizers for this opportunity to address you. Before I begin with my comments, I have to mention that, notwithstanding I am an investment negotiator with the Peruvian Government, my comments does not represents the official position of Peru.

As Mr. Tracton said, the "fair and equitable treatment" obligation is found not only in NAFTA, but in many international investment agreements around the world. And Mr. Tracton has explained us the NAFTA Parties' interpretation of the corresponding provision in NAFTA, as well as the interpretation of the NAFTA Free Trade Commission on this general treatment provision and the steps that the United States has taken to clarify the interpretation of the fair and equitable treatment standard in other recent investment agreements.

I may say that I totally agree with the approach that the references to "fair and equitable treatment" and to "full protection and security" which we could find in most of the investment treaties in force, may not exceed the Party's obligation under international law. They are concepts to be applied as and to the extent they are recognized in customary international law, specifically, the customary international law minimum standard of treatment of aliens.

I am sure that most of the participants to this seminar will disagree with the approach that a measure that bothers an investor may be find as a breach of the obligation to accord the "fair and equitable treatment" standard. I am also sure the audience here would share the concern of the NAFTA governments on the interpretation the tribunals adopted in the cases mentioned by Mr. Tracton.

The interpretation from the NAFTA Commission making clear that tribunals may only find a violation of Article 1105(1) if the claimant has identified a rule of customary international law that has been breached by the NAFTA Party as well as the determination that an alleged breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1), protects the states against misinterpretations and exaggerated pretensions from the investors.

But I would like to go back to one of the initial remarks from Mr. Tracton: he mentioned that the minimum standard of treatment is an absolute obligation. A Party must provide this level of treatment regardless of the level of treatment it provides to investments of its own investors.

On this regard, I would like to briefly refer two cases:

The first case, the dispute between Asian Agricultural Products Ltd (AAPL) and Sri Lanka, ICSID Case No. ARB/87/3, deals with the question of the extent of protection a host State is required to provide to a foreign investor under a BIT and international law.

- In January 1987, a farm owned by AAPL in Sri Lanka was destroyed and its employees killed during a military operation conducted by the security forces of Sri Lanka. The operation was said to be aimed against installations used by local insurgents.
- AAPL initiated arbitration proceedings under ICSID, referring to the BIT between Sri Lanka and the United Kingdom which had been extended to Hong Kong.
- AAPL argued that “full protection and security” would create strict liability of the host State for any destruction of the foreign investment.
- The tribunal finds that the obligation to provide full protection and security cannot entail strict liability without any need to prove that the damages suffered were attributable to the State.
- But, once the tribunal examined the host State’s responsibility under customary international law, it concludes that the State failed to comply with its “due diligence” obligation. The governmental authorities should have taken precautionary measures before launching the attack on the farm.

The second case, the dispute between American Manufacturing & Trading, Inc. (AMT) and the Republic of Zaire, ICSID Case No. ARB/93/1, is a case addressing the issues of protection and compensation for property damage:

- As a result of looting and destruction of property caused by certain members of Zairian armed forces in 1991 and in 1993, AMT a US company had suffered considerable losses.
- AMT claimed that the Republic of Zaire had violated its rights recognized and protected by the provisions of the BIT between the United States and Zaire.
- Article II (4) specifies that the protection and security of investment must not be any less than those recognized by international law.
- Furthermore, the tribunal refers to Article IV (1) (b) of the BIT, which confirms the engagement of Zaire's responsibility. Zaire cannot set aside its responsibility by invoking national legislation. It is an international obligation, which Zaire has freely contracted within the BIT.
- At the beginning, the tribunal found that the facts did not disclose an expropriation by the State as there was no direct evidence that the looting was committed by the armed forces. The mere fact that the persons involved were attired in military uniforms would not suffice for the action being attributable to the State.
- Finally, the tribunal finds that, by taking no measure to ensure the protection and security of the investment, Zaire has failed to respect the minimum standard required by international law and has breached its obligation under the BIT.

According to this two cases, should we conclude that the reference to “full protection and security” may not exceed the Party’s responsibility to comply with its “due diligence” obligation?

Thank you very much.

**Comments on Fair and Equitable Treatment Standard in
International Investment Law**

by

Mr. Tomoaki Ishigaki²³

Deputy Director, Legal Affairs Division
Ministry of Foreign Affairs of Japan

In my brief response, I would like to provide some general observations on “fair and equitable treatment” and point out difficulty in identifying its specific content. I also hope to touch upon its relations with customary international law.

The debate on what is fair and equitable can be quite philosophical and ambiguous. As Mr. Tracton pointed out, there are varying views on how to interpret a clause with “fair and equitable treatment” contained in numerous investment related treaties. Recent practices, particularly in NAFTA cases of interpretation have raised some concerns among governments as well as investors; that is to say, decisions related to “fair and equitable treatment” can be rather difficult to predict, thus damaging legal stability of international investment. The approach taken by the NAFTA which Mr. Tracton has just explained us is a practical approach in responding to such concerns.

As Japan is now concluding various FTAs, and it may encounter in future a case related to “fair and equitable treatment,” the issue is quite relevant and important to us. It is true that Japan has few experience on investors-to-state arbitration based on investment treaties. Nonetheless, in order for us to find an adequate balance where interests of both governments and investors are protected, there is a strong interest by Japan on this subject.

Going back to the specific contents of “fair and equitable treatment”, I agree with Mr. Tracton’s view that it is an absolute standard, in a sense that, there is certainly a set of standard contained in the concept. In other words, there is a set of standard which receiving government of such investors cannot deviate from. Many state practices, arbitration decisions and formulation of bilateral treaties, including those on commerce and navigations, clearly show that there are certain sets of standard contained in that concept, and have reached the level of customary international law.

For example, access to proper judicial process is certainly one of the core factors that can be included in “fair and equitable treatment.” If a recipient government refuses such access and proper remedy, it will be held responsible for “denial of justice.” The basic principle on non-discrimination is also pointed out in various decision and scholarly works as a key idea contained in the concept of what is “fair and equitable.” It would be safe to point out that there is an overall consensus that these two elements are also a part of customary international law on investment protection.

Let me now turn to the point made by Mr. Tracton on the relations between “fair and equitable treatment” and customary international law. Like the example of NAFTA which Mr. Tracton described, it is a useful exercise to link the two so as to identify the specific contents of fair and equitable treatment through utilizing customary international

²³ The view expressed in this remarks are purely personal in its nature and does not necessarily reflect the view of the organization to which he belongs.

law. Through clarifying its scope, it would become possible to avoid any arbitrariness or subjective judgment in deciding what is “fair” and “equitable.”

In this regard, it is worth pointing out that there is an overlap as well as differences between the two concepts of “fair and equitable treatment” and customary international law on international investment.

-On one hand, two examples on “fair and equitable treatment” which I raised, namely, (1) prohibition on denial of justice, and (2) the principle of non-discrimination can certainly be qualified as a part of customary international law. Physical protection of life and property of investors are also very basic and fundamental treatment that foreign investors can enjoy.

- In the meantime, it should be noted that physical protection and security is often named separately from “fair and equitable treatment” in a treaty, thus making it an independent interest. It may be obvious but still worthwhile pointing out that, just like in the case of “full protection and security,” the standard which amounts to the level of customary international law does not always a part of “fair and equitable treatment.”

With regard to the state practice of Japan, Japan concluded a number of international agreements that have a clause on fair and equitable treatment on foreign investments. It is of Japan’s view that “fair and equitable treatment” clause in bilateral treaties basically reaffirms the customary international law which obligates any State to accord a certain level of treatment to foreign investments in its territory.

As I stated at the very beginning of this remarks, the difficulty of ascertaining the exact scope of “fair and equitable treatment” would still exist despite all kinds of efforts. The main reason for such difficulty arises because state parties to a treaty can agree on the scope on each treaty, and also because the concept is an evolving one. In other words, the environment surrounding international investment changes and the level of expectation among the people both within governments and business world also changes in time.

For example, it is certainly possible that in some treaties, parties in question decide to apply tests or standards in determining whether foreign investments were treated in a fair and equitable manner. Without referring to the core concept of treaty law, *pacta sunt servanda*, it is obvious that states are free to agree on they deem appropriate. They may also add some additional meaning to the concept through reaching an agreement. In this regard, it is difficult to rule out categorically that “fair and equitable treatment” would not accord higher level of treatment compared to “minimum standard in customary international law.”

In addition, whoever engaged in treaty negotiations also know from their experiences that, in some cases, states prefer to leave some ambiguity in certain clauses as they cannot predict everything that may happen in the future. The level of expectations concerning investment protection may change, and States may sometimes find it more appropriate to leave some room open.

Another difficulty related to identifying the scope of fair and equitable treatment is the fact that the exact contents of the concept is questioned only when applying it to the actual situation. In this regard, in any foreign investment case, there is always a need to examine the background of the case. Not only the factual aspects of the issue, but also

the background of the treaty which States have concluded needs also be looked into. It is necessary to examine the specific wording of the treaty as well as its negotiating history often found in *travaux preparatoire* of that treaty. Therefore, it should be noted that the specific contents of “fair and equitable treatment” can only be identified on a case-by-case basis.

To sum up, I would like to point out the following:

First, “fair and equitable treatment” certainly sets a level of standard on protection accorded to foreign investors in accordance with bilateral treaties, and it overlaps with customary international law concerning the treatment of foreign investment in one country. A recipient country is legally bound to provide certain protection to its investors.

Second, it is worthwhile trying to identify the specific content of what is included in that “fair and equitable treatment”. The principle of non-discrimination and prohibition on denial of justice are certainly some of them, and they are also part of customary international law. This is an overlap between the two, namely “fair and equitable treatment” and customary international law. The approach taken by the NAFTA countries by linking the two in their treaty clause is certainly a useful and effective approach in identifying the scope of “fair and equitable treatment.”

Third, despite various efforts, it is still difficult to make an exhaustive and universally acceptable list of “fair and equitable treatment”. This is mainly because states that conclude bilateral treaties are free to agree on what kind of treatment they accord under the clause containing “fair and equitable treatment.” There is, of course, a certain limit on what countries can agree. However, states that enter into an agreement, depending on the specific negotiating history as well as their intention on what they would like to secure from this agreement can agree on a certain set of tests and standards in determining what is “fair” and “equitable”. Furthermore, the standard on what is fair and equitable is an evolving one, and can change in time. Such evolving nature of the standard also makes it difficult to ascertain its clear-cut definition.

Indirect Expropriation and the Right of the Governments to Regulate
Are There Any Criteria to Articulate the Difference?

by

Catherine Yannaca-Small

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Investment Division of the OECD Directorate

There is some concern in various policy communities that one or more traditional treaty protections for foreign investment may interfere with the right of governments to take normal governmental action without paying compensation. The OECD Investment Committee is currently examining these issues.

My presentation today will focus on one of the questions under examination: the distinctive features of indirect expropriation requiring compensation and the right of the governments to regulate without offering compensation.

As you may all know, international customary law does not preclude host states from expropriating foreign investments provided certain conditions are met. These conditions are: the taking of the investment for a public purpose, as provided by law, in a non-discriminatory manner and with compensation – or, to state the classical standard more fully, “prompt, adequate and effective compensation”.

Expropriation, could take different forms:

- it could be *direct* where an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright physical seizure. International law is clear that a seizure of legal title of property constitutes a compensable expropriation; or
- could also occur through interference by a state in the use of that property or with the enjoyment of the benefits even where the property is not seized and the legal title to the property is not affected; the measures taken by the State have a similar effect to expropriation or nationalisation and are generally termed *indirect* or measures “tantamount” to expropriation.

In recent times, disputes related to nationalisation of investments that marked the 70s and 80s have been replaced by disputes related to foreign investment regulation and indirect expropriation. Foreign investors have increasingly made claims for compensation based on governmental regulations, such as placing restrictions on the legal use of property that do not actually remove the owner’s title to the property but nevertheless substantially affect its value or the owner’s control. Largely prompted by the first cases brought under NAFTA, there is some concern that concepts such as indirect expropriation may be applicable to regulatory measures aimed at protecting the environment, health and other welfare interests of society.

Despite a number of decisions of international tribunals, the line between the concept of indirect expropriation and governmental regulatory measures not requiring compensation has not been clearly articulated and depends on the specific facts and circumstances of the case. However, while case-by-case consideration remains necessary, there are some criteria emerging from the examination of some international agreements and arbitral decisions for determining whether an indirect expropriation requiring compensation has occurred.

In this context, my presentation will be an overview of how existing international agreements and arbitral decisions attempt to draw this line by highlighting a number of criteria.

1) International Agreements

States have included protection against indirect expropriation in various forms of international instruments. Literally all relevant investment protection treaties and draft treaties provide for indirect expropriation or measures tantamount to expropriation. However, most stay mute on the treatment of the non-compensable regulatory measures.

In the past, a few draft international agreements, such as the 1967 OECD Draft Convention on the Protection of Foreign Property and the draft OECD Multilateral Agreement on Investment, while themselves silent on the non-compensable regulatory measures, were accompanied by commentaries which did address the issue.

The commentaries to the *1967 OECD Convention on the Protection of Foreign Property*²⁴ did so by making it clear that the concept of “taking” is not intended to apply to normal and lawful regulatory measures short of direct taking of property rights, but rather, to misuse of otherwise lawful regulation to deprive an owner of the substance of his rights.

In the case of the *draft Multilateral Agreement on Investment (MAI)*²⁵, this was done by addressing it in the Chairman’s report, in interpretative notes and finally in an OECD Ministers’ Declaration which stated that: “the MAI would establish mutually beneficial international rules which would not inhibit the normal non-discriminatory exercise of regulatory powers by governments and such exercise of regulatory powers would not amount to expropriation”.

While the distinction was addressed in doctrine through the early Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens²⁶ and the commentary to the American Law Institute’s Restatement of Foreign Relations Law of the United States²⁷, the only agreements which include language addressing the distinction and make reference to the right of the State to regulate are: the *European Convention on Human Rights and Fundamental Freedoms*, and the recently concluded *Free Trade Agreements between the US and Chile, Central America, Australia, Morocco and Singapore*. The new *US model Bilateral Investment Treaty* also addresses the distinction.

- The Article 1 of Protocol 1 of the *European Convention on Human Rights and Fundamental Freedoms* (hereafter the European Convention on Human Rights), concluded in 1952 and entered into force in 1954, although it does not say so explicitly, it strongly implies that the duty to compensate is not applicable to normal regulation:

²⁴ “Draft Convention on the Protection of Foreign Property and resolution of the Council of the OECD on the Draft Convention”, 12 October 1967, pp.23-25

²⁵ The Multilateral Agreement on Investment (Report by the Chairman of the Negotiating Group) DAF/MAI(98)17, 4 May 1998 available at <http://www1.oecd.org/daf/mai/pdf/ng/ng9817e.pdf>

²⁶ See 23 *AJ* (1929).

²⁷ American Law Institute, “Restatement of the Law Third, the Foreign Relations of the United States”, *American Law Institute Publishers, Volume 1, 1987, Section 712, Comment g.*

“Every natural or legal person is entitled to the peaceful enjoyment of its possessions. No one should be deprived of his possessions except in the public interest and subject to the conditions provided for by the law and by the general principles of international law.

The proceeding provisions shall not, however, in any way impair the right of a state to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

This Convention of course, does not focus on special rights for foreigners, but treats the rights of all persons.

- During the last year, several new **Free Trade Agreements between the US and Australia²⁸, Chile,²⁹ Central America,³⁰ Morocco³¹ and Singapore³²** (expressed in the exchange of letters on expropriation) have included language addressing the distinction. They state:

a) “The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:

- The economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
- the extent to which the governmental action interferes with distinct, reasonable, investment backed expectations; and
- the character of the governmental action.

(b) Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety and the environment, do not constitute indirect expropriations”.

- The new *US Model BIT³³* and *Canada’s Foreign Investment Promotion and Protection Agreement (FIPA³⁴)* contain language along the lines of these Free Trade Agreements.

2) Jurisprudence

How have the international arbitral tribunals dealt with the issue? With the exception of few early cases, and before the recent NAFTA cases which stirred up considerable discussion on this matter, the two most prominent sources of such decisions were the Iran-United States Claims Tribunal and decisions arising under Article 1,

28. US-Australia Free Trade Agreement signed on March 1, 2004, [Annex 11-B, Article 4(b)].

29. The US-Chile Free Trade Agreement was signed on June 6, 2003 (Annex 10-D).

30. US-Central America Free Trade Agreement (CAFTA) signed on January 28, 2004, (Annex 10-C). The Central American countries are: Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua.

³¹ US-Morocco Free Trade Agreement signed on June 15, 2004 (Annex 10-B).

32. US Trade representative Robert Zoellick to Singapore Minister of Trade and Industry, George Yeo on 6 May, 2003.

³³ For the text of the model BIT see <http://www.state.gov/e/eb/rls/prsr/2004/28923.htm>

³⁴ For the text of the new FIPA model see http://www.dfait-maeci.gc.ca/tna-nac/what_fipa-en.asp

Protocol 1 of the European Convention for the Protection of Human Rights. Today, we see more cases based on bilateral investment agreements dealing with this issue.

Have they shed any light to this discussion? Although there are some “inconsistencies” in the way some arbitral tribunals have distinguished legitimate non-compensable regulations having an effect on the economic value of foreign investments and indirect expropriation requiring compensation, a careful examination will reveal that, in broad terms, they have identified some criteria which look very similar to the ones laid out by the recent agreements: i) the degree of interference with the property right, ii) character of governmental measures, i.e. the purpose and the context of the governmental measure, and iii) interference of the measure with reasonable and investment-backed expectations.

i) The Degree of interference with the property right

Most international decisions treat the severity of the economic impact caused by a government action as an important element in determining whether it rises to the level of an expropriation requiring compensation. International tribunals have often refused to require compensation when the governmental action did not remove essentially all or most of the property’s economic value. There is broad support for the proposition that the interference has to be quite substantial in order to constitute expropriation, i.e. when it deprives the foreign investor of fundamental rights of ownership, or when it interferes with the investment for a significant period of time, by rendering it useless. Mere restrictions on the property rights do not constitute takings.

The **European Court of Human Rights** (ECHR)³⁵ has found an expropriation where the investor has been definitely and fully deprived of the ownership of his/her property. If the investor’s rights have not disappeared, but have only been substantially reduced, and the situation is not “irreversible”, there will be no “deprivation” under Article 1, Protocol 1 of the European Convention of Human Rights.³⁶ In the most widely cited case under Article 1, *Sporrong and Lönnroth v. Sweden*³⁷ (1982), the Court did not find indirect expropriation to have occurred as a result of land use regulations that affected the claimant’s property because:

“...although the right [of peaceful enjoyment of possessions] lost some of its substance, it did not disappear...The Court observes in this connection that the [claimants] could continue to utilise their possessions and that, although it became more difficult to sell properties [as a result of the regulations], the possibility of selling subsisted”.

35. The European Court of Human Rights is the Court established by the Council of Europe under the Protection of Human Rights and Fundamental Freedoms Convention, to determine questions brought before it by individual petitioners or signatory states concerning violations of human rights by signatory states.

36. See cases: *Handyside v. United Kingdom*, 24 Eur. Ct. H.R. (ser.A) at 29 (1976); *Poiss v. Austria*, 117 Eur. Ct.H.R. (ser. A)84, 108 (1987); *Matos e Silva, Lda v. Portugal* App. No. 15777/89, 24 Eur. Ct. H.R. rep. 573, 600-01 (1996).

37. In this case, long-term expropriation permits (23 and 8 years) had been granted by the city of Stockholm in respect of the applicant’s properties. These did not of themselves expropriate the property, but gave local authorities the power to do so, should they so decide in the future. *Sporrong and Lönnroth* complained that it was impossible for them to sell these properties and that it amounted to an interference with their right to peaceful enjoyment of possessions. The Swedish government, by contrast, emphasised the public purpose of the permits system and the intentions of the city of Stockholm to make improvements for the general good.

In cases³⁸ under **the Iran-United States Claims Tribunal**³⁹ such as *Starrett Housing*⁴⁰, and *Tippets*⁴¹, the Tribunal concluded that an expropriation had taken place because the property rights have been rendered useless or that the owner was deprived of fundamental rights of ownership and the deprivation was not merely ephemeral.

In the **NAFTA** context, in the *Pope & Talbot* case⁴², the Tribunal found that “...mere interference is not expropriation; rather, a significant degree of deprivation of fundamental rights of ownership is required”.⁴³

In *S.D. Myers*⁴⁴, the Tribunal distinguished regulation from expropriation primarily on the basis of the degree of interference with property rights: “expropriations tend to involve the deprivation of ownership rights; regulations [are] a lesser interference”.⁴⁵

In *Marvin Roy Feldman Karpa (CEMSA) v. United Mexican States*,⁴⁶ the Tribunal found that there was no expropriation since “the regulatory action has not deprived the Claimant of control of his company, interfered directly in the internal operations of the company or displaced the Claimant as the controlling shareholder. The Claimant is free to pursue other continuing lines of business activity...

The arbitral Tribunal in the case *CME (the Netherlands) v. the Czech Republic* examined a claim based on the bilateral investment treaty between the Netherlands and the Czech Republic⁴⁷. The Tribunal found that an expropriation had occurred because CME’s operations were destroyed and the joint venture was left as a company with assets, but without business.

▪ *Economic impact as the exclusive criterion*

³⁸ For details of these cases see H. Seddigh, “What level of Host State Interference Amounts to a Taking under Contemporary International Law? *Journal of World Investment, 2001, Vol.2, No 4, pp. 631-84* and G.H. Aldrich, “What Constitutes a Compensable taking of Property? The Decisions of the Iran-United States Claim Tribunal”, *The American Journal of International Law, Vol. 88 pp. 585-609*.

³⁹ The Iran-United States Tribunal was established in 1981 in order to adjudicate claims by nationals of each country following the Iranian revolution. Its creation was pursuant to the Algiers Declarations which resolved the hostage crisis between Iran and the United States.

⁴⁰ “[I]t is recognised by international law that measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner

⁴¹ “While assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that the deprivation is not merely ephemeral...”.

⁴² *Pope & Talbot Inc. v. Government of Canada*, Award (April 10, 2001).

43. In addition, the Tribunal stated that: “Regulations can indeed be characterised in a way that would constitute creeping expropriation....Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protection against expropriation”, see Award paragraph 99.

⁴⁴ *S.D. Myers Inc. v. Government of Canada*, Award (November 13, 2000)

45. The Tribunal added that: “the distinction between expropriation and regulation screens out most potential cases of complaints concerning economic intervention by a state and reduces the risk that governments will be subject to claims as they go about their business of managing public affairs”.

46. In this case, Marvin Feldman, a United States citizen, submitted claims on behalf of CEMSA. ICSID Case No. ARB(AF)/99/1, Award of 16 December 2002, pp. 39-67 at 59.

47. *CME (Netherlands) v. Czech Republic (Partial Award)* (13 September, 2001) available at www.mfcr.cz/scripts/hpe/default.asp

As I mentioned above, the severity of the impact is one of the main factors in determining whether a regulatory measure effects an indirect expropriation. What is more controversial is the question of whether the focus on the effect will be the exclusive relevant criterion – ‘sole effect doctrine’ – or whether the purpose and the context of the governmental measure may also enter into the takings analysis. The outcome in any case may be affected by the specific wording of the particular treaty provision.

A few cases have focused on the effect of the owner as the main factor in distinguishing a non-compensable regulation from a taking. The **Iran-United States Tribunal**, in the *Tippetts and Phelps Dodge* case, held that the intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact.

In the context of the **NAFTA**, in the *Metalclad* case,⁴⁸ the Tribunal found a violation of NAFTA Article 1110 on expropriation and stated that in order to decide on an indirect expropriation, it “need not decide or consider the motivation, nor intent of the governmental measure”

The case *Compañía del Desarrollo de Santa Elena v. Costa Rica*,⁴⁹ although it dealt with a direct expropriation, not an indirect taking, it has attracted particular attention in the indirect takings discussion because the panel expressly stated that the environmental purpose had no bearing on the issue of compensation. The Tribunal held that: “expropriatory environmental measures – no matter how laudable and beneficial to society as a whole – are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state’s obligation to pay compensation remains”.

ii) ***Character of governmental measures, i.e. the purpose and the context of the governmental measure***

A very significant factor in characterising a government measure as falling within the expropriation sphere or not, is whether the measure refers to the State’s right to promote a recognised “social purpose” or the “general welfare” by regulation.

In the context of the European Convention of Human Rights, **the European Court of Human Rights** has given States a very wide margin of appreciation concerning the establishment of measures for the public interest and has recognised that it is for national authorities to make the initial assessment⁵⁰ of the existence of a public concern warranting measures that result in a “deprivation” of property. The Court held that the state’s judgement should be accepted unless exercised in a manifestly unreasonable way.

In addition, the Court has adopted a common approach to “deprivations” and “controls” of use of property. In either case, there has to be a reasonable and foreseeable national legal basis for the taking, because of the underlying principle in stability and

48. *Metalclad Corporation v. United Mexican States* (Tribunal Decision August 30, 2000).

49. *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1. (February 17, 2000).

50. The state margin of appreciation is justified by the idea that national authorities have better knowledge of their society and its needs, and are therefore ‘better placed than [an] international [court] to appreciate what is in the public interest’”. See *James v. United Kingdom*, 98 Eur. Ct. H.R. (ser. A) 9, 32 (1986).

transparency and the rule of law. In relation to either deprivation or control of use, the measures adopted must be proportionate. The Court examines whether the interference at issue strikes a reasonable balance between the demands of the general interest of the community and the private interests of the alleged victims of the deprivation and whether an unjust burden has been placed on the claimant. In order to make this assessment, the Court proceeds into a factual analysis insisting that precise factors which are needed to be taken into account vary from case to case.

In the **NAFTA** context, in *S.D. Myers*, the Tribunal noted that it must also look at the real interests involved and the purpose and effect of the government measure”.

- *“Police Powers” of the State*

The notion that the exercise of the State’s “police powers” will not give rise to a right to compensation has been widely accepted in international law. However, the “police powers” doctrine is viewed by some not as a criterion which is weighted in the balance with other factors and broadly encompasses government actions in the public welfare but as a controlling element and a narrower concept which *de facto* exempts the measure from any duty for compensation.

In the context of the **Iran-United States Claims Tribunal**, the only award in which an allegation of taking was rejected on the grounds of police power regulations was *Too v. Greater Modesto Insurance Associates*,⁵¹ where the claimant sought compensation for the seizure of his liquor licence by the United States Internal Revenue Service. The Tribunal said that: “...a State is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation or any other action that is commonly accepted as within the police power of States, provided it is not discriminatory.

The Tribunal in the *Lauder*⁵², case said about the interference with property rights that, “detrimental effect on the economic value of property is not sufficient; Parties to [the Bilateral] Treaty are not liable for economic injury that is the consequence of bona fide regulation within the accepted police powers of the State”.

In the case of *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States*,⁵³ the investor, Técnicas Medioambientales Techmed, S.A., although the Tribunal found an expropriation, it has stated that: “the principle that the State’s exercise of its sovereign power within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is undisputable”.

iii) *Interference of the measure with reasonable investment-backed expectations*

Another criterion identified is whether the governmental measure affects the investor’s reasonable expectations. In these cases the investor has to prove that his/her investment was based on a state of affairs that did not include the challenged regulatory

51. Award December 29, 1989, 23 Iran-United States Cl. Trib. Rep.378.

52. *Lauder (U.S.) v. Czech Republic* (Final Award) (September 3, 2002) available at www.mfcr.cz/scripts/hpe/default.asp

53. *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Award Case No. ARB (AF)/00/2.

regime. The claim must be objectively reasonable and not based entirely upon the investor's subjective expectations.

The **Iran-U.S. Claims Tribunal** in *Starett Housing Corp. v. Iran* took into account the reasonable expectations of the investor:

“Investors in Iran, like investors in all other countries, have to assume a risk that the country might experience strikes, lock-outs, disturbances, changes of economic and political system and even revolution. That any of these risks materialised does not necessarily mean that property rights affected by such events can be deemed to have been taken”.

In *Marvin Roy Feldman Karpa (CEMSA) v. United Mexican States* the **NAFTA Tribunal** noted:

“Governments, in their exercise of regulatory power, frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social considerations. Those changes may well make certain activities less profitable or even uneconomic to continue...”.

In *Tecnicas Medioambientales Tecmed S.A, v. The United Mexican States*, the Tribunal attempted to determine whether the Mexican government's measures were “reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of who suffered such deprivation”. “...Even before the Claimant made its investment, it was widely known that the investor expected its investments to last for a long term and that it took this into account to estimate the time and business required to recover such investment and obtain the expected return ...”. To evaluate if the actions attributable to the Respondent– violate the Agreement, such expectations should be considered legitimate and should be evaluated in light of the Agreement and of international law”.

Concluding remarks

As a conclusion I would say that, indirect expropriation appears to be a very different matter than direct expropriation. Direct expropriation must be compensated, while to fall into the category of compensable indirect taking, most cases require something more than the effect on the investment. Although certain criteria emerge broadly out of state practice and jurisprudence, some caution remains necessary. New generation investment and Free Trade agreements are being concluded at a very fast pace. Investment disputes is an area which is rapidly evolving. The number of cases going to arbitration is growing and case-by-case consideration may continue to shed additional light. The list of criteria which we could identify today from state practice and the existing cases is not necessarily exhaustive but open to evolution.

Indirect Expropriation and the Right to Regulate

by

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I would like to thank the organiser for the invitation to this timely seminar, in particular to Ms. Maria Elena Varas for her tireless efforts in bringing about this event. My thanks also extend to Ms. Catherine Yannaca-Small for her paper on Indirect Expropriation which I found a very good summary of the situation.

Summary of the Issue

The issue at hand is about Indirect Expropriation and its relationship with the Right to Regulate. In the past, expropriation was the most important aspect of investment protection agreements. As Alejandro Buvinic put it, “expropriation was the golden rule of investment protection.”⁵⁴ One of the reasons why it was so important was probably because states taking property was of key concern for investors after the war.

International customary law as well as many bilateral investment treaties (BITs) has specified 4 conditions where expropriation can be taken:

- Must be for public purpose;
- Applied on a non-discriminatory basis;
- Compensation is provided;
- Due process is made available.

However, direct expropriation has become less important in recent times because fewer and fewer states have made direct expropriation. Instead, there has been a shift of interest to “indirect expropriation” which is generally understood as state measures that “tantamount” to expropriation.

While international law has clearly established that direct expropriation must be compensated, rules on indirect expropriation are not as clear-cut. Even common definition of indirect expropriation is not available though Ms. Yannaca-Small has summarised that indirect expropriation could be “interference by a state in the use of that property or with the enjoyment of the benefits even where the property is not seized and the legal title to the property is not affected;”

The uncertainty of what exactly could be considered “indirect” expropriation and whether compensation must be provided or not has raised question on the extent that government’s right to regulate might be compromised. The fact that foreign investors could make claims for compensation based on governmental regulations is increasingly a cause of concerns for many governments. It could also have important bearings on developing countries’ flexibility in taking policy and measures.

⁵⁴ Buvinic, Alejandro (2002). “Protection and Guarantees in Investment Agreements” from APEC Workshop on Bilateral and Regional Investment Rules/Agreements held on 17-18 May 2002 at Merida, Mexico

Attempts to Clarify the Issue

There have been attempts to clarify what are measures that “tantamount” to expropriation and what protection investors would be entitled to. But, as pointed out by Ms. Yannaca-Small, most investment agreements do not touch on the treatment of the non-compensable regulatory measures.

The “new generation” Free Trade Agreements particularly those concluded by the US with other countries demonstrate the attempt to provide a clearer context to decide what can be construed as indirect expropriation that must be compensated. The relevant provisions in these agreements state that each situation must be considered on a case-by-case, fact-based basis and must consider:

- economic impact of the government action -- but the economic value of an investment does not establish that an indirect expropriation has occurred;
 - the extent to which the governmental action interferes with distinct, reasonable, investment-backed expectations; and
 - the character of the governmental action.
- except in rare circumstances, non-discriminatory regulatory actions by a party for legitimate public welfare objectives do not constitute indirect expropriation.

International tribunal jurisprudence also has interpretation of indirect expropriation. Though the criteria are not identical to those mentioned above, they are broadly similar. These criteria of consideration are:

- (1) The degree of interference with the property right
- (2) Character of governmental measures ie., the purpose and context of the government measures; and
- (3) Interference of the measure with reasonable and investment-backed expectations.

The latter part of Ms. Yannaca-Small’s paper focuses on providing detailed determination of relevant cases on each point above.

Comments on the Jurisprudence

From the jurisprudence presented in the paper, there are some interesting points. Using economic impact caused by government action as the primary criteria is understandable. The general agreement is that the interference has to be quite substantial and that degree of interference is key (eg., deprivation of ownership rights). The existence of a regulation and mere interference by the state is not enough to entitle investors to compensation. Most jurisprudence supports this view.

But on a few occasions, there is jurisprudence which says that government intention or motivation does not have to be taken into account at the same level of economic impact. This seems to be somewhat incongruent with the next criteria.

The second criteria state that what counts for government is how the state exercises the right. From the paper, it seems that if the state measure is for a recognised “social purpose” and “general welfare” then it is acceptable.

For the EU, a further condition seems to be that the measures adopted must be “proportionate” while in NAFTA, a case has reinforced the fact that the real interests involved and the purpose and effect of the government measure is important. Further, if

the state exercises “Police Powers” then it is generally acceptable that no compensation is needed.

The last point on reasonable expectation seems logical enough.

Infringement on the Right to Regulate: Commenting from a Developing Country’s Point of View

In principle, expropriation should be dealt with clearly as a part of investment protection. Investors and investment should be protected against abusive government actions.

But most BITs and FTA chapters on investment tend to focus mainly on investor’s and investment’s protection. The “new generation” agreements also have important sections that deal with investment “liberalisation”. Indeed, there is not much on host country’s right – only obligations. In my view, investment agreements are basically investor’s rights agreement.

It is worth remembering that developing countries do need FDI for their development. Therefore, they should retain positive outlook towards investors and most would undoubtedly extend protection and other treatments to investors willingly. But developing countries’ governments should also be given proper flexibility in their development pursuit. The rules and interpretation of indirect expropriation could reduce such flexibility.

Investment agreements as well as the investment chapters in FTAs tend to have broad scope, covering both FDI and portfolio investment. They also cover investment in all sectors – services, manufacturing, etc. Most FTAs would go for negative-list approach which means deeper liberalisation. As such, host-countries concerns should have been taken into account as much as investors and investment protection.

The Right to Regulate is one such flexibility that developing countries should have. In particular, their governments should be able to undertake necessary regulatory measures without too much worry that they will be challenged frequently by investors for compensation. In addition to a few international agreements that implicitly recognised the Right to Regulate, it is explicitly recognised under the General Agreement on Trade in Services (GATS). Therefore, investment in service sectors would get protection while the government would have some room to take appropriate measures. To a certain extent, other WTO agreements such as Technical Barriers to Trade and Sanitary and Phytosanitary Measures also tacitly recognised the Right to Regulate. Such recognition, if future jurisprudence does not give much weight to government’s intention in making regulation, might be infringed by rules on indirect expropriation.

How to Deal with the Situation

The current language used in some FTAs is pointing towards the right direction but not yet enough. Some paragraphs that mention non-discriminatory regulatory actions could be further revised and/or expanded to lend more weight to the Right to Regulate. Relying on jurisprudence is not predictable – at least from a government’s point of view.

So in negotiating bilateral agreements with provisions on expropriation,⁵⁵ developing countries may need to include additional language somewhere that provides for the Right to Regulate (not necessarily only in the expropriation part). They should also consider making appropriate reservations in areas they deem vital for their future development efforts. At the same time, provisions on investment-related dispute settlement should be given appropriate attention. The negotiating approach and implementation of these agreements must also be more accommodative of development goals.

Summary

There is no doubt that investors and investment should be given proper protection and therefore clear rules on expropriation should continue to be part of investment agreements. Yet, each government should also have ample room for undertaking necessary developmental measures. The balance between these two objectives may not be easy to achieve as demonstrated by the concept of “indirect expropriation.” Recent attempts to form commonly acceptable criteria on what constitute indirect expropriation and what is the government’s Right to Regulate in investment area is going towards the right direction. But more could be done. The best thing for some developing countries on this issue would be to understand what is needed for their future developmental purposes and try to create rooms for flexibility for policy measures. This is easier said than done but it has to be at least recognised in the first place.

⁵⁵ There is currently no provision on “Indirect Expropriation” but it could appear in the form of Annex.

Most-Favoured-Nation Treatment

by

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Introduction

Estimados huéspedes de Chile, estimados huéspedes del APEC, Estimados participantes de este seminario, ladies and gentlemen:

I am pleased to speak to you today on Most-Favored-Nation Treatment in investment agreements. This is quite an appropriate subject for this beautiful resort of Pucon!

MFN treatment is, as we know, one of the founder principles of international trade policy, going back to the middle ages. It is also a central element of the international investment policy as it has emerged over the last twenty years from the bilateral investment treaties, regional integration agreements and some WTO obligations such as the GATS.

Recent arbitral awards have, however, raised new questions on the scope of these treaty clauses.

My main message this morning will be simply this: negotiators of MFN clauses be well advised of the importance of paying close attention of the “formulation” of the MFN clauses that you negotiate. Do not hesitate to make your intentions clear. This could prove very valuable in the context of investment disputes.

To illustrate this point, I will briefly touch upon:

- (1) The diversity of MFN treaty clauses in investment agreements;
- (2) Rules of treaty interpretation; and
- (3) Recent case law.

Examples of MFN clauses in investment agreements

To provide MFN treatment is generally understood to mean that an investor from a party to an agreement, or its investment, will be treated by the other party “no less favorably” than an investor from any third country investor or its investment with regard to the matters covered by the MFN clause.

A stocktaking of such MFN clauses does not yield a uniform picture however. Some MFN clauses are narrow in scope, others are broader. It is estimated that there at least some 20 different formulations of such clauses across the 2200 investment agreements in existence. The context of the clauses also varies, as does the object and the purpose of the treaties which contain them.

The standard MFN clause in the *German model BIT* is free standing and not restricted in its scope to any particular part of the treaty containing it. A separate clause

of this Model, however, only relate to full protection and expropriation matters, limiting its scope to these matters.

In the *UK agreements*, the MFN clause relates to a number of specified parts of the Agreement. Parts not listed fall presumably outside the scope of the clause. The MFN clause in the UK/Albania agreement covers practically all the provisions of the Agreement, including dispute settlement procedures.

The typical formulation of an MFN clause in the *US and Canadian BITs* cover both the establishment and post establishment phases. It lists the various operations covered and makes it explicit that the right to MFN treatment only applies “in like circumstances”. This formulation is reproduced in the recent Free Trade Agreements concluded by the United States with Chile, Singapore, Central America and Australia and the new model US BIT and Canadian BIT. The final draft text of US-Central America Agreement also contains an interpretative footnote on the scope of application of the MFN clause stating that the clause does not encompass international dispute settlement mechanisms.

In addition, specific restrictions and exceptions are often attached to the clauses, which exclude certain areas from their application. Widespread limitations concern regional or economic integration agreements and taxation, subsidies or government procurement. The Canadian and US agreements also have “country” exceptions or reservations attached to them as “non-conforming measures” listed in separate annexes to their agreements. There are also special annexes devoted to exceptions to MFN treatment.

Some US and Canadian BITs also contain limitations to the MFN clauses that preclude coverage of the advantages accorded by virtue of multilateral agreements or negotiations, the so-called GATT/WTO clause. This exception appeared for the first time in the US-Poland BIT and can also be found in the Canada-Chile Agreement. A few WTO members have also listed substantive provisions in their bilateral investment treaties as involving exemptions to the MFN obligations of the GATS with a view of protecting a higher level of treatment in such BITs in relation to GATS commitments.

Finally, there is the Understanding reached by the United States, the European Commission and new EU members last September which aims at avoiding potential incompatibilities arising from MFN obligations in the BITs and the obligations of membership in the European Union.

Basic rules of interpretation of MFN clauses

The customary rules of interpretation of public international law are to be found in the Articles 31-32 of the Vienna Convention. The basic rule stated in Article 31.1 of that Convention is that “a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”⁵⁶ This rule applies to the interpretation of MFN clauses and attaches great importance to their formulation.

56. In Article 31.2, the word “context” is held to include the preamble and annexes of the treaty as well as any agreement or instrument made by the parties in connexion with the conclusion of the treaty. Article 31.3 further states that there shall be taken into account, together with the context, any subsequent agreement or practice relating to the treaty together with any relevant rules of international law. According to Article 31.4, a special meaning can also be given to a term “if it is established that the parties so intended”. Where the interpretation according to the provisions of Article 31 needs confirmation, or

Some of you may recall that the International Law Commission (ILC) made an attempt in the mid-60s to the late 70's to codify the MFN clause. While this major effort did not succeed, largely to the complexity of the undertaking, the ILC did identify some general principles for interpreting MFN clauses which are still in use today.

The most well-known principle is the "ejusdem generis" principle. This principle states the rule according to which a MFN clause can only attract matters belonging to the same subject matter or the same category of subject to which the clause relates. If the benefit to be derived from the third party treaty relates to issues different from the subject-matter or the same category of subject of the MFN clause, the MFN clause will not apply.

The ILC recognised, however, while the meaning of the rule is clear, its application is not always easy. Moreover, the ILC Draft Articles on MFN were intended to have a residual character. They were developed "without prejudice to any provision on which the granting State and the beneficiary State of a MFN clause may otherwise agree".⁵⁷ Thus, the content of the treatment due in each specific case is defined first of all by the actual language of the MFN clause in question.

Recent case Law

Among the numerous cases brought to ICSID in recent years,⁵⁸ only four cases have involved claims or references to MFN clauses, two brought up under bilateral agreements, two under NAFTA.

The first case is the famous **Maffezini v. Kingdom of Spain(2000)** ⁵⁹. It concerned a dispute between an Argentine investor, Emilio Augustin Maffezini and the Spanish entities, in connection with an investment in Galicia. Spain objected to ICSID jurisdiction because the investor had failed to comply with the requirement contained in the bilateral investment agreement between Argentina and Spain to try local remedies for 18 months before going to international arbitration. Maffezini argued, on the other hand, that the same MFN clause allowed him to invoke Spain's unconditional acceptance of ICSID arbitration in the agreement concluded with Chile.

The ICSID Tribunal decided that,⁶⁰ by virtue of the MFN clause of the Argentine-Spain agreement, which covered "all matters subject to the Agreement", the claimant had the right to import the more favourable "jurisdictional" provisions of the Chile-Spain Agreement.

The Tribunal based its reasoning on the *ejusdem generis* principle⁶¹, to which I referred earlier, and an old case, the *Ambatielos* case, which suggested that MFN clause

determination since the meaning is ambiguous or obscure or leads to a manifestly absurd or unreasonable result, recourse can be made to the supplementary means of interpretation under Article 32. These means include the preparatory works (*travaux préparatoires*) of the treaty and the circumstances of its conclusion.

57. In this sense, see also *Oppenheim's International Law, op. cit.*, p. 1328.

58. By the latest account, 29 new cases have been registered by the Centre in 2003, as compared to 15 such claims in 2002 and only 12 and 5 in 2001 and 2000.

59. Emilio Augustin Maffezini v. Kingdom of Spain (ICSID No. Apr/97/7), Decision on Jurisdiction of 25 January 2000 and Award of the Tribunal of 13 November 2000. These decisions are available at <http://www.worldbank.org/icsid/cases>.

60. Decision on Jurisdiction of 25 January 2000, http://www.worldbank.org/icsid/cases/emilio_DecisiononJurisdiction.pdf

61. Id. at para. 56.

can apply to the “administration of justice”. It also considered that today’s dispute settlement arrangements are “inextricably related” to the protection of foreign investors.

But while extending the application of the MFN clause to procedural or jurisdictional questions, the Tribunal also considered that “as a matter of principle, the beneficiary of the clause should not be able to override public policy considerations that were fundamental to the contracting parties’ acceptance of the agreement. This would appear to be the case in regard to the inclusion of (a) an exhaustion of local remedies clause; (b) a fork on the road clause; (c) a reference to a given arbitration forum in the Agreement; and (d) a highly institutionalised system of arbitration with precise rules such as those found in NAFTA. It is not clear whether these limitations reflect any coherent principle of policy however.

The second case is **Tecmed v. Mexico (2003)**^{62,63} involving a dispute between a Spanish investor in Mexico. The ICSID Tribunal was called upon to decide whether the investment agreement between Spain and Mexico, Spanish investor, to a retroactive application of its claims in view of a more favourable treatment of this matter under the agreement between Austria and Mexico. The Tribunal rejected the argument on the basis that matters relating to the application over time of the Agreement “go to the core of matters that must be deemed to have been specifically negotiated by the Contracting Parties”. It also stated that the dispute settlement of this agreement fell outside the MFN clause in question. While the Tribunal referred to the Maffezini judgment, the conclusion it reached does appear to be entirely consistent with the reasoning of the Maffezini Tribunal.

The third case is **ADF Group v. United States (2002)**⁶⁴. This is the only completed NAFTA claim involving a breach of the MFN clause. However, the Tribunal dismissed the claim because it involved government procurement, a subject excluded from the application of the Investment Chapter of NAFTA.

The fourth case is **Pope & Talbot Inc. v. Canada (2001, 2002)**⁶⁵ where the claimant did not allege a breach of MFN treatment but rather a breach of the minimum standard of treatment. However, the merits award suggested that an MFN clause could lead to the import into the basis agreement the more favourable conditions found in some BITs.

Where this does leaves us?

First, despite their prevalence in investment treaties, MFN clauses do not have a universal meaning.

62. Técnicas Medioambientales Tecmed, S.A. v. United Mexican States [ICSID Case No. ARB(AF)/00/2] <http://www.worldbank.org/icsid/cases/laudo-051903%20-English.pdf>

63. It has also been reported that the German investor claimant in Siemens AG v. Argentine Republic, ICSID case No. ARB/02/08 may also use the Maffezini construction in this case. See “Investor-State Arbitration: A Hot Issue in Latin America, Guido Santiago Tawil, M. & M. Bomchil, Buenos Aires. Horacio D. Rosatti makes a similar observation on the implications of the Maffezini case in “*Bilateral Investment Treaties, Binding International Arbitration and the Argentine Constitutional System*”, in *La Ley*, 15 October 2003.

⁶⁴ <http://www.state.gov/s/l/c3754.htm>

⁶⁵ <http://www.dfait-maeci.gc.ca/tna-nac/pope-en.asp>

A proper interpretation of the particular language of an MFN clause requires a close examination of the text of the clause in accordance with international treaty interpretation rules.

Although it is too early to draw conclusions, recent case law has raised serious interrogations.

One of is whether and to what extent an MFN clause in one investment agreement will extend to the dispute settlement provisions of another agreement. Another is the extent to which an MFN clause in a treaty with an intentionally narrowly drawn substantive provision will import into that treaty a potentially more favourable provision on the same subject matter from a different agreement with a different country.

It is to be hoped that future case law will enlighten the debate. The consequences are far reaching. MFN clauses link investment agreements to each other. They provides for equal competitive opportunities. MFN treatment is a central element in providing security and predictability to the international investment relations.

Thank you very much for your attention. Muchas gracias.

International Investment Disputes: New Challenges

by

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1. Investor to state dispute settlement has always been one of the cornerstones in our bilateral Investment Protection Agreements, without which we would consider the treatment and guarantees provisions of those agreements of limited significance if not downright useless.

For a number of years we have all negotiated and concluded such agreements with, what we considered state-of-the-art provisions, for the protection of our investors and, then, more or less forgot about them, as they were rather rarely invoked in practice.

2. It is only recently that they have started to come into our attention again when their dispute settlement provisions started to be used by investors.

We found out then, from the awards rendered by arbitral tribunals, that certain standard clauses in our agreements were interpreted by tribunals in quite a different way than what we had in mind when drafting them (fair and equitable treatment – NAFTA) and others proved too far reaching in their application (indirect expropriation).

I think the first collective choc came at the time we were negotiating the MAI, with the Ethyl case,⁶⁶ when we realized that a standard indirect expropriation clause could be applied in such a way that the Governments' right to regulate was imperilled.

The proliferation of investor-state disputes since then, which started with NAFTA Chapter 11 but has now moved over firmly to BITs/ippas cases, have started to raise *questions* with regard to the current system of *international arbitration in investment disputes*.

3. The shortcomings of the system are the *new "hot topic"* in the field of international investment rules, actually studied and analyzed and monitored in different circles, from academic institutions to UNCTAD and organizations concerned with the development aspects of investment.

And, although it may be *too early* to draw conclusions about the interpretation of the *substantive rights* contained in BITs and their implications for Governments as the issues on which tribunals have been called upon to decide present tremendous diversity and the awards produced are relatively few, *the procedural rules* governing the system are appearing to be deficient.

4. The system, deriving from the confidential world of international commercial arbitration (with the exception of ICSID) does not seem to accommodate the needs of investment cases, where states are involved and *most often issues of public interest are at stake* which have to be balanced with private economic rights.

⁶⁶ The Canadian Government prohibited, in April 1997, the import and commercialisation of the chemical substance MMT as dangerous for human health. *Ethyl*, a multinational company based in the USA and sole producer of the substance, submitted a case against the Canadian Government to international arbitration, claiming that this prohibition constituted a measure tantamount to expropriation, on the basis of NAFTA provisions and asking for compensation. The case was subsequently settled out of court.

It has come out that the international arbitration system lacks some of the elements of the classic judicial system, notably *transparency, legitimacy and accountability*.

Lack of transparency: Proceedings are not generally accessible to the public and, depending on the forum of arbitration, the awards may never be published. This deprives policy makers from learning from these awards and taking them into account when contemplating new measures on investment. It also excludes concerned third parties who may want to intervene in the public interest.

The selection of arbitrators: Arbitrators are appointed on the basis of their legal expertise which in a number of cases may not be enough to deal with the complex and technical aspects of a particular case that may require expertise in anything, from monetary policy to environmental issues. The freedom of the parties to choose their arbitrator can have a decisive influence on the outcome of a case, depending on the “eminence” of the specific arbitrator. Conflict of interest problems may arise as often the same persons act as counsel in certain cases and as arbitrators in others.

Conflicting awards/ multiple arbitrations: As each investor is free to choose a forum of international arbitration and, in most agreements, there is no provision for consolidation of related cases we may have and have had, multiple arbitration proceedings (the case of Argentina)⁶⁷ and conflicting awards on the same Government measure (the Czech cases)⁶⁸. This leads to the absence of a uniform interpretation of the same rule and creates uncertainty in governments with regard to conformity with their treaty obligations.

Review of awards/Lack of an appellate mechanism: Most BITs provide that arbitral awards are final and binding for the parties to the dispute and have to be carried out promptly by the State concerned. This means that, depending on the arbitration forum, awards are subject to *limited review* in accordance with the rules of the arbitral system used for resolving the dispute and on the basis only of procedural defects.

No appellate mechanism, that is a mechanism which permits a challenge to the award as regards the substance of the decision where this shows a defect in law, is provided for and national courts are not involved. As a consequence, we run the risk of having to enforce aberrant decisions and there is no possibility of developing coherent jurisprudence.

5. The perceived problems of the system have pushed *Governments to action*. Some are more concerned than others because of the sheer number of cases in which they are involved and have acted accordingly.

The *United States*, notably, is inserting clauses in its FTAs providing for open proceedings in investment arbitrations under the agreements and the publication of related documents, whereas *NAFTA* Governments (and *NAFTA* itself) provide for the consolidation of related claims in their BITs.

⁶⁷ The Argentinean Government in December 2001, introduced emergency measures to salvage the economy, including the devaluation of the peso, which resulted in a flood of cases against it submitted by affected foreign investors on the basis of BITs.

⁶⁸ In the late 1990s two related UNCITRAL arbitrations were instituted against the Czech Republic, one by the affected company, the other by a major shareholder, challenging the same government measure. One tribunal wholly vindicated the Government, the other found that it had violated various provisions of the BIT invoked and ordered compensation.

European Governments up to now have had no or *few negative experiences* from the international arbitration system as, awards based on European ippas invoked against them, are still relatively few.

This may be due to the fact that most European ippas are concluded with developing countries with no significant investments in Europe or, possibly, to differences in the litigation culture of American and European lawyers who lack the aggressiveness of their American colleagues. It is impressive, to me at least, that a few weeks after the Argentinean Government devaluated the peso (December 2001), in January 2002, a large American law firm with international branches was already posting a briefing, in its website, apprising foreign investors of their rights against the Government on the basis of BITs and offering its specialized services.

In Europe, up to now, we have seen no reason to amend our model ippas either to give more guidance to arbitrators or to deal with any *lacunes* in the dispute settlement mechanism.

(Most of us have only one bilateral agreement with detailed Investor-State dispute settlement provisions, the one with Mexico, on which our Mexican colleagues insisted due to their experience with NAFTA cases.)

However, we all see that the number of cases is on the rise and that there is good reason to look into the issues raised with regard to international arbitration.

6. At *the OECD* which is, at the moment, the only forum where matters of international investment rules and policy can be discussed, the *Committee on International Investment and Multinational Enterprises* had a very interesting meeting, last December, with Argentinean experts who gave us a very interesting analysis of the situation the country is facing with 21, by now, cases pending against it, based on BITs.

And, although, the Argentinean problem is stemming from a particular situation, the systemic issues connected with it, i.e. multiple parallel proceedings, possible conflicting awards and the enforcement problems ensuing, linked with the absence of an appellate mechanism are of interest to all of us and the Committee decided to *look into those systemic issues*.

We will start with *Transparency* and *Third Party Participation*, the *Review/Appellate* mechanisms and problems connected with the *Enforcement* of awards.

Further down the road, we will examine the issues of Consolidation, the Selection of Arbitrators but also the matter of choice between local legal remedies and International Arbitration (“the fork in the road”) as well as the usefulness of excluding certain government measures from Investor-State dispute settlement provisions.

7. *ICSID is a case apart*. It is, of course, the only arbitral institution that was created for the settlement of *investment* disputes. As it goes through its continuously augmenting caseload, it seems to become more like a national court, in the sense that it tries to balance public and private interests, is striving for transparency and uniform interpretation, but is still lacking in certain aspects, most notably an appellate mechanism.

It is a fact that when disputes arise, investors prefer to take their cases to ICSID, than to any other institution proposed to them under a BIT or institute *ad hoc* proceedings and this will continue.

A strictly personal thought, in my capacity as an ippa drafter, negotiator, interpreter and “implementator”, on how to face the “New challenges” in the settlement of international investment disputes:

Get a better understanding of all the issues that are currently raising concerns, which is what we are trying to do at the moment and, then, amend the Washington Convention accordingly, at the same time limiting the international arbitration options offered in our BITs, for Investor-State dispute settlement, to ICSID.

It will take long and will be hard but it will also ensure certainty for law, Governments and the business community.

APEC Investment Principles

Mr. Julio Bravo

Director (Program), APEC Secretariat

Introduction

APEC was established in 1989. From the original 12 economies today we are a forum of 21 member economies from all corners of the Pacific. 2.6 billion people live in the APEC region, we have a combined Gross Domestic Product of around US\$19.3 trillion, and our economies account for over 47% of global trade.

Together, all 21 member economies are working to build a greater sense of social and economic community. We are building bridges across the Pacific to develop common understandings, to share technology, to trade and invest, and to build prosperity.

The primary goals of the APEC process were first laid out by the Leaders of APEC economies when they met in Bogor, Indonesia, in 1994.

Leaders set the target of achieving free trade and investment in the APEC region by the year 2010 for developed economies, and the year 2020 for developing economies. These targets have become known as the Bogor Goals.

As APEC progresses towards the Bogor Goals, much of its work is directed through what is known as "*The Three Pillars of APEC*". These are:

Ø Trade and investment liberalization

APEC has been successful in removing barriers and opening markets for all member economies to expand trade and investment across their borders.

When APEC was formed, most economies had average tariff rates of more than 10%, now only three members have tariffs at this level.

The removal of these barriers takes away the inefficiencies that have for so long held many businesses and economies back, and slowed prospects of economic growth.

But most importantly, in real terms, the removal of these impediments to trade has made it easier for businesses in all economies, particularly small and medium-sized businesses, to obtain cheaper inputs to production and to export their own goods and services to more markets.

Ø Business facilitation

The area of business facilitation is closer to the hearts of business people. While APEC puts a lot of attention into lowering tariffs on goods and services in the region, we are also aware of the need to focus on non-tariff impediments to trade and investment.

The objective of APEC business facilitation efforts is to cut the red tape that prevents business people from getting on with doing their jobs and trading across borders. As part of this, APEC Leaders have pledged to make a 5% reduction in transaction costs throughout the region by 2006. This 5% reduction in red tape is

expected to generate an additional US\$280 billion⁶⁹ for the regional economy. This is a substantial saving that will be shared by businesses through the region.

APEC members have also committed to implement the APEC Transparency Standards. These provide business and investors with comprehensive and clear information on the rules and regulations of each APEC member.

Ø Economic and Technical Cooperation (ECOTECH)

ECOTECH facilitates the technical assistance required for APEC members to benefit from trade and investment liberalization.

ECOTECH activities support APEC's efforts to overcome gaps between developed and developing economies, and promote equitable development.

The programs initiated by ECOTECH assist all member economies to achieve prosperity through activities that strengthen the competitiveness of the business and government sectors.

The Three Pillars of APEC assist government and business in our member economies to deal more efficiently across borders and to become more competitive in the global economy.

Committee on Trade and Investment

The APEC Committee on Trade and Investment (CTI) was established in 1993 with the objective of creating a coherent APEC perspective and voice in global trade and investment issues. It was also aimed at pursuing opportunities to liberalize and expand trade, facilitate a more open environment for investment and develop initiatives to improve the flow of goods, services, capital, and technology within the region.

In 1995, leaders approved the Osaka Action Agenda (OAA) which is APEC's roadmap to free and open trade and investment. The OAA is pursued through concerted unilateral liberalization grounded in voluntarism and collective initiatives.

The OAA defined the following general principles to be applied to the entire APEC process to achieve the long term goals:

1. Comprehensiveness

The APEC liberalization and facilitation process will be comprehensive, addressing all impediments to achieving the long-term goal of free and open trade and investment.

2. WTO-Consistency

The liberalization and facilitation measures undertaken in the context of the APEC Action Agenda will be WTO-consistent.

⁶⁹ Trade Facilitation: A Development Perspective in the Asia Pacific Region (World Bank study) – page 6.

http://econ.worldbank.org/files/20929_APEC_TF_Report_Final.pdf

3. Comparability

APEC economies will endeavor to ensure the overall comparability of their trade and investment liberalization and facilitation, taking into account the general level of liberalization and facilitation already achieved by each APEC economy.

4. Non-discrimination

APEC economies will apply or endeavor to apply the principle of non-discrimination between and among them in the process of liberalization and facilitation of trade and investment. The outcome of trade and investment liberalization in the Asia-Pacific region will be the actual reduction of barriers not only among APEC economies but also between APEC economies and non-APEC economies.

5. Transparency

Each APEC economy will ensure transparency of its respective laws, regulations and administrative procedures which affect the flow of goods, services and capital among APEC economies in order to create and maintain an open and predictable trade and investment environment in the Asia-Pacific region.

6. Standstill

Each APEC economy will endeavor to refrain from using measures which would have the effect of increasing levels of protection, thereby ensuring a steady and progressive trade and investment liberalization and facilitation process.

7. Simultaneous start, continuous process and differentiated time tables

APEC economies will begin simultaneously and without delay the process of liberalization, facilitation and cooperation with each member economy contributing continuously and significantly to achieve the long-term goal of free and open trade and investment.

8. Flexibility

Considering the different levels of economic development among the APEC economies and the diverse circumstances in each economy, flexibility will be available in dealing with issues arising from such circumstances in the liberalization and facilitation process.

9. Cooperation

Economic and technical cooperation contributing to liberalization and facilitation will be actively pursued.

Investment Experts' Group

During the first APEC Leaders meeting held in Seattle in 1993, Leaders welcomed the report presented by the APEC Eminent Persons Group that recommended to “adopt an Asia Pacific Investment Code to reduce the uncertainties and transactions cost of trade and investment in the region”. On that occasion, Leaders instructed CTI to provide a set of Non-binding Investment Principles. In 1994 CTI established the Investment Experts Group (IEG) to address this task, and the first outcome of the IEG was the **APEC Non-Binding Investment Principles**, which were approved by APEC Leaders in Jakarta, November 1994

With the aim to increase the investment flows in the region and having in mind the spirit of open regionalism of APEC, members agreed in the following non-binding principles:

Transparency

- Member economies will make all laws, regulations, administrative guidelines and policies pertaining to investment in their economies publicly available in a prompt, transparent and readily accessible manner.

Non-discrimination between Source Economies

- Member economies will extend to investors from any economy treatment in relation to the establishment, expansion and operation of their investments that is no less favourable than that accorded to investors from any other economy in like situations, without prejudice to relevant international obligations and principles.

National Treatment

- With exceptions as provided for in domestic laws, regulations and policies, member economies will accord to foreign investors in relation to the establishment, expansion, operation and protection of their investments, treatment no less favourable than that accorded in like situations to domestic investors.

Investment Incentives

- Member economies will not relax health, safety, and environmental regulations as an incentive to encourage foreign investment.

Performance Requirements

- Member economies will minimise the use of performance requirements that distort or limit expansion of trade and investment.

Expropriation and Compensation

- Member economies will not expropriate foreign investments or take measures that have a similar effect, except for a public purpose and on a non-discriminatory basis, in accordance with the laws of each economy and principles of international law and against the prompt payment of adequate and effective compensation.

Repatriation and Convertibility

- Member economies will further liberalise towards the goal of the free and prompt transfer of funds related to foreign investment, such as profits, dividends, royalties, loan payments and liquidations, in freely convertible currency.

Settlement of Disputes

- Member economies accept that disputes arising in connection with a foreign investment will be settled promptly through consultations and negotiations between the parties to the dispute or, failing this, through procedures for arbitration in accordance with members' international commitments or through other arbitration procedures acceptable to both parties.

Entry and Sojourn of Personnel

- Member economies will permit the temporary entry and sojourn of key foreign technical and managerial personnel for the purpose of engaging in activities connected with foreign investment, subject to relevant laws and regulations.

Avoidance of Double Taxation

- Member economies will endeavour to avoid double taxation related to foreign investment.

Investor Behaviour

- Acceptance of foreign investment is facilitated when foreign investors abide by the host economy's laws, regulations, administrative guidelines and policies, just as domestic investors should.

Removal of Barriers to Capital Exports

- Member economies accept that regulatory and institutional barriers to the outflow of investment will be minimised.

Following Leaders' agreement to expand intra-regional trade and investment to achieve the Bogor Goals, the APEC Ministers instructed Senior Officials to develop concrete actions and measures to achieve these goals. The IEG undertook to compile the "Options for Investment Liberalization and Business Facilitation to Strengthen the APEC Economies - For Voluntary Inclusion in Individual Action Plans" or the "*Menu of Options*" which is a non-exhaustive "*master menu*" of investment-liberalizing and business-facilitating measures from which economies may voluntarily select any of a number of *options* to make progress toward creating a free and open investment regime.

The Menu of Options contains fifteen categories, namely: General Policy Framework; Transparency; Non-discrimination (most-favored-nation treatment, national treatment, ownership, finance and capitalization); Expropriation and Compensation; Protection from Strife; Transfers; Performance Requirements; Entry and Stay of Personnel; Settlement of Disputes; Intellectual Property; Avoidance of Double Taxation; Competition Policy and Regulatory Reform; Business Facilitating Measures; Technology Transfer and Venture Capital and Start-up Companies.

The IEG has been continuously updating this menu and has completed a review of the status of its implementation in 2004.

The beneficiaries or recipients of APEC IEG work and outcomes have been mainly the government officers responsible of investment, the private sector, investors, SMEs and the academia.

One of the latest deliverables of the IEG is the fifth edition of the "APEC Guide to the Investment Regimes of the APEC Member Economies", which was published in August 2003 and is available on the APEC Secretariat website.

Compiled to make cross-border investment more transparent and simple, the guidebook has been produced through the individual contributions of APEC member economies working with local business communities. It is intended to overcome a lack of clarity in regulations and procedures across different economies, which is one of the greatest impediments to free trade and investment. The publication provides information on the following six major topics:

- Background on the foreign investment regime
- Regulatory framework and investment facilitation
- Investment protection
- Investment promotion and incentives
- Summary of international investment agreements or codes to which the APEC member is a party
- Assessment of recent trends in foreign investment

Between 1994 and May 2004 there have been 30 meetings and the Group has undertaken various initiatives addressing the APEC general and IEG specific principles, mainly dealing with transparency, investment facilitation and capacity building.

APEC IEG has achieved the following collective actions:

- APEC Non-binding Investment Principles (1994).
- Action Plan on Investment as a Contribution to the Osaka Action Agenda (1995)
- First APEC Symposium on Investment (Bangkok 1995)
- Third Guide of Investment Regimes of the APEC Member Economies (1996)
- Second APEC Symposium on Investment (Tokyo 1996)
- Third APEC Symposium on Investment (Hong Kong, China 1997)
- Seminar on Implementation of TRIMS Agreement (Hong Kong, China 1997)
- Fourth APEC Symposium on Investment (Kuala Lumpur 1998)
- Second Business Survey (1998)
- Training Program to Improve Member Economies' Capabilities on Statistical Reporting and Data Collection (China 1998)
- Published 4th edition of the Investment Guidebook (1999)
- APEC Investment Mart in Seoul (1999)
- Compiled the compendium of Initiatives, Development Efforts, Aspirations and Strategies (IDEAS) for the four stakeholders (foreign direct investor, home economy, host economy and domestic investor) involved in the international flow of FDI's. (1999)
- Seminars on FDI Policy and Administration Adjustment in Bangkok (1999)
- Seminar on Start Up Companies and Venture Capital in Chinese Taipei (1999)
- Training program on Strategies to Identify and Facilitate Investment in Specific Areas e.g. small and medium enterprises (SMEs) development and industrial linkages, high tech industries and R&D activities. (1999)
- Training program on awareness for APEC investment /trade officials to understand and be informed of the various option for investment liberalization and business facilitation. (1999)
- Fifth APEC Symposium on Investment (Shanghai 2000)
- Two workshops on the Menu of Options (2000)
- Finalized the new e/IAP chapter format on investment (2000)
- Developed the Menu of Facilities offered in a one-stop agency (2000)
- Agreed to make cross-reference between IAPs and Menu of Options
- Sixth APEC Investment Symposium on "Restructuring FDI in the Age of Information Technology (Cheju 2001)
- Expanded the Menu of Options to include the areas of technology transfer, intellectual property rights, start-up companies/venture capital and domestic business environment. (2001)
- Second APEC Investment Mart in Yantai, China (2001)
- APEC Seminar on "WTO TRIMs Agreement Implementation: Capacity Building for a Better Investment Environment (Xiamen, China 2001)
- Updated investment chapter of the OAA Guidelines and the Investment Collective Actions through reflecting improvements made in 2001.
- Seminar on "Investment's One – Stop Shop" (Lima, Peru 2002)
- Workshop on "Bilateral/Regional Investment Rules and Agreements" (Merida, Mexico; 17-18 May 2002)
- Seventh APEC Investment Symposium (Vladivostok, Russia, September 2002)
- Third APEC Investment Mart (Vladivostok, Russia; September 2002)
- Revised wording of the Osaka Action Agenda, items (b) and (d) under Investment Guidelines

- Study on APEC Cross-border Mergers & Acquisitions.
- Study on Venture Capital Investment in APEC Economies, May 2003.
- Published 5th Edition of the APEC Investment Guidebook, August 2003.
- “Study on International Investment Instruments and their Legal Interpretations”, as a contribution to the WTO, on August 2003 in Phuket, Thailand.
- Study on Cross-border M&As: Case Studies of Korea, China and Hong Kong, China, August 2003.
- Expanded the Menu of Options on “Competition Policy and Regulatory Reform”.
- Fourth APEC Investment Mart held in Bangkok in October 2003.
- APEC Seminar on Venture Capital and Start-up Companies (Beijing, China; December 2003)
- APEC IEG-OECD Seminar on Current FDI Trends & Investment Agreements, Pucón, Chile May 2004)

Future work.

To explore cooperation with other international organizations, such as OECD - UNCTAD dealing with investment issues in order to identify synergies and work in a cooperative way. This seminar is clear example of such cooperation.

FTA's/RTAs are now also being including in APEC work Agenda and the IEG will be engaging in policy discussion on the investment dimension of such agreements.

APEC leaders in 2002 adopted the Statement to Implement the APEC Transparency Standards and directed that these Standards be implemented no later than January 2005. In this regard, despite the progress already achieved by IEG in this area, the Group will continue addressing transparency.

In the last 10 years the IEG has helped to open and make more transparent the investment environment in the region. The exchange of information, the capacity building activities and the tools developed in this regard are the main outcomes of a group committed with the goals settled by our Leaders' in Bogor in 1994.

Thank you.



APEC Investment Principles

IEG-OECD Seminar on Current FDI Trends and
Investment Agreements: Challenges and Opportunities

Julio Bravo
APEC Secretariat

Pucón, Chile 26 May 2004



APEC

- Established in 1989 with 12 original members.
- 21 member economies from all corners of the Pacific
- Major contributor of global prosperity and stability
- Roughly one third of the world's population, 2.5 billion
- Combined GDP of approx US\$18 trillion (More than half of total world production)
- 47% of global trade



BOGOR GOALS

Free and open trade and investment in
the Asia-Pacific by 2010 for developed
member economies and 2020 for
developing ones

APEC'S THREE PILLARS



- Trade and Investment Liberalization
- Business Facilitation
- Economic and Technical Cooperation

Committee of Trade and Investment (CTI)



- Established in 1993
- Objectives:
 - Greater market access
 - Reduce business costs
 - Greater transparency and business friendly environment
 - Greater government and business sector cooperation
 - Facilitate business/trade

OSAKA ACTION AGENDA (OAA)



- Adopted in 1995.
- The OAA is pursued through concerted unilateral liberalization grounded in voluntarism and collective initiatives.

PRINCIPLES



- Comprehensiveness
- WTO consistency
- Comparability
- Non-discrimination
- Transparency
- Standstill
- Simultaneous start, continue process and differentiated timetable
- Flexibility
- Cooperation

APEC Investment Experts' Group



- Established in 1994 by C TI to develop the Asia Pacific Non Binding Investment Principles.
- Reconvened in 1995 to provide advice to C TI on investment issues and to develop the Osaka Action Agenda.

APEC Investment Non Binding Principles, Jakarta November 1994



- APEC members aspire to the following non-binding principles:
- Transparency
 - Non-discrimination between Source Economies
 - National Treatment
 - Investment Incentives
 - Performance Requirements
 - Expropriation and Compensation

APEC Investment Non Binding Principles, cont.



- Repatriation and Convertibility
- Settlement of Disputes
- Entry and Sojourn of Personnel
- Avoidance of Double Taxation
- Investor Behavior
- Removal of Barriers to Capital Exports

Menu of Options on Investment



- "Options for Investment Liberalization and Business Facilitation to Strengthen the APEC Economies - For Voluntary Inclusion in Individual Action Plans"
- Non-exhaustive "master menu" of investment-liberalizing and business-facilitating measures from which economies may voluntarily select any of a number of options to make progress toward creating a free and open investment regime.

Menu of Options, cont.



- General Policy Framework:
- Transparency:
- Non-discrimination (most-favored-nation treatment, national treatment, ownership, finance and capitalization):
- Expropriation and Compensation:
- Protection from Strife:
- Transfers:
- Performance Requirements:

Menu of Options, cont.



- Entry and Stay of Personnel;
- Settlement of Disputes;
- Intellectual Property;
- Avoidance of Double Taxation;
- Competition Policy and Regulatory Reform;
- Business Facilitating Measures;
- Technology Transfer and
- Venture Capital and Start-up Companies.

APEC Guide to the Investment Regimes of the APEC Member Economies



- Fifth Edition, August 2003
- Investment more transparent and simple.
- Produced through the individual contributions of the 21 APEC member economies working with local business communities.
- Intended to overcome a lack of clarity in regulations and procedures across different economies which is one of the greatest impediments to free trade and investment.
- Compiled in a way that is easy for both the public and private sectors to use.

APEC Guide to the Investment Regimes of the APEC Member Economies, cont.



- Provides information on the following six major topics:
- Background on the foreign investment regime
 - Regulatory framework and investment facilitation
 - Investment protection
 - Investment promotion and incentives
 - Summary of international investment agreements or codes to which the APEC member is a party
 - Assessment of recent trends in foreign investment

IEG Main Collective Actions Achieved



Since its inception in 1994, the IEG has held 29 meetings and achieved the following main collective actions:

- APEC Non-binding Investment Principles (1994)
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IEG Main Collective Actions Achieved, cont.



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- Developed the Menu of Facilities offered in a one-stop agency (2000)
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- Expanded the Menu of Options to include the areas of technology transfer, intellectual property rights, start-up companies/venture capital and domestic business environment. (2001)
- Second APEC Investment Mart in Yantai, China (2001)
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IEG Main Collective Actions Achieved, cont.



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- Study on Cross-border M&As: Case studies of Korea, China and Hong Kong, China. August 2003.
- Fourth APEC Investment Ministerial held in Bangkok in October 2003.
- APEC Seminar on Venture Capital and Start-up Companies (Beijing, China: December 2003)
- APEC IEG-OECD Seminar on Current FDI Trends & Investment Agreements. Pucón, Chile (May 2004)

APEC IEG Future work



- APEC IEG – OECD Cooperation
- FTAs/RTAs Investment provision
- Commitment on Transparency

MORE INFORMATION ON APEC IEG



www.apec.org

Seminar on
**“Current FDI Trends and Investment Agreements:
Challenges and Opportunities”**

Pucón, 25-26 May 2004
Gran Hotel Pucón

DRAFT AGENDA

Tuesday 25 May 2004

- 8:30-9:00 **Registration**
- 9:00-9:30 **Welcoming remarks by Ms. Maria Elena Varas**, Coordinator of the Seminar and Legal Assistant of the General Directorate of Foreign Economic Affairs, Chile
- Opening speech by Mr. Mario Matus**, APEC Senior Official and Director for Bilateral Affairs in the General Directorate of Foreign Economic Affairs, Chile
- 9:30-11:00 **Part I: Recent FDI Trends and Future Perspectives**
- Chair: Mr. Juan Orduña**, IEG Chair

Following two years of sharp declines, international direct investment flows in most countries bottomed out and began to recover 2003. Within the OECD area the turnaround is largely driven by an improving macroeconomic outlook in the main economies, and by higher stock prices which have helped rekindle cross-border mergers and acquisitions. Non-OECD APEC countries saw their FDI inflows fall as well in 2000-2002, but they were generally less affected than the OECD economies. China, in particular, emerged as the world's biggest recipient of direct investment in 2002. If FDI inflows to some of APEC economies have in the past been less cyclical than in other parts of the world, an important question for every policymaker is how best to ensure that their economies reap the full benefits of the present recovery on a sustainable basis.

Presentations

- **Mr. Fernando Martel Garcia**, World Bank, on **Global Finance in a Cyclical Upturn: Opportunities and Challenges** (15 minutes)
- **Mr. Hisashi Michigami**, Director of the Ministry of Foreign Affairs in charge of investment issues on **Recent Development of Bilateral Investment Rules in East Asia** (15 minutes)

Responses to the presentations

- **Ms. Daisy Kohan**, Head of Statistics and Forecasts, Foreign Investment Committee of Chile (8-10 minutes)
- **Ms. Maryse Robert**, Principal Trade Specialist, Organisation of American States (8-10 minutes)

General discussion (30-35 minutes)

11:15-11:45

Coffee Break

11:45-12:55

Part II: Key obligations in International Investment Agreements

Chair: Mr. Vernon Mackay, Vice-Chair of the OECD Investment Committee, Canada

Session 1. Transparency

Transparency is generally viewed as an important element to good public and private sector governance. It also figures prominently among investors' concerns and has been embraced by APEC and OECD as a key liberalisation principle. Last October both organisations announced new steps towards the implementation of more transparent legal regimes. These initiatives show a remarkable degree of convergence on the economic benefits and the means for achieving regulatory transparency. The session will provide an opportunity to discuss transparency standards and discuss implementing issues.

Presentation

Mr. Roy Nixon, Manager, Foreign Investment Division, the Treasury of Australia (15 minutes)

Responses to the presentation

- **Mr. Alejandro Faya**, Deputy Director General, Ministry of the Economy, Mexico (10 minutes)
- **Ms. Anna Joubin-Bret**, UNCTAD Secretariat (10 minutes)

General discussion (30-35 minutes)

12:55-14:45

Lunch

14:45-17:30

Part II: Continuation

14:45-16:00

Session 2. The “Fair and Equitable Treatment” Standard

The standard of “fair and equitable treatment” has become one of the most invoked elements of investment protection in international investment agreements. At the same time, the definition of the standard has engendered a debate, in particular in the context of the rapid proliferation of bilateral investment treaties during the last two decades. This debate has mainly focused on the relationship of “fair and equitable treatment” with the “minimum standard of treatment” required by international customary law. It has revived recently with the first cases dealing expressly with the “fair and equitable treatment” in the context of several BITs and NAFTA. The session will provide an opportunity to discuss this issue between OECD and APEC investment experts.

Presentation

Mr. Michael K. Tracton, Investment Negotiator, Office of Investment Affairs, U.S. Department of State, United States (15 minutes)

Responses to the presentation

- **Mr. Carlos Herrera**, Proinversión, Government of Peru (10 minutes)
- **Mr. Eric H. Leroux**, Senior Counsel, Trade Law Bureau, Department of Foreign Affairs and International Trade, Canada (10 minutes)
- **Mr. Tomoaki Ishigaki**, Deputy Director, Legal Affairs Division, Treaties Bureau, Ministry of Foreign Affairs, Japan (10 minutes)

General discussion (30-35 minutes)

16:05-16:30 **Coffee break**

16:30-17:40 **Session 3. Indirect Expropriation and the Right to Regulate**

The line of demarcation between the concept of indirect expropriation requiring compensation and governmental regulatory measures not requiring compensation is not easy to draw. Some of the relevant cases brought to arbitral tribunals were determined on the basis of recognition that governments have the right to protect, through non-discriminatory actions, *inter alia*, the environment, human health and safety, market integrity and social policies without providing compensation for any incidental deprivation of foreign owned property. But in some other recent cases, tribunals have disregarded the purpose and the context of the government measures to determine whether compensation was due. Many international instruments with provisions on indirect expropriation focus on effect and few expressly carve out the normal exercise of regulatory authority or other governmental power. Recent Free Trade Agreements between the United States and Chile,

Singapore, Central America, and Australia, by introducing specific language and establishing criteria to assist in determining whether an indirect expropriation requiring compensation has occurred, represent the most recent attempt by governments to strike the balance between private rights and public policies. The session will offer an opportunity to have an exchange of views on these issues.

Presentation

Ms. Catherine Yannaca-Small, Legal Advisor, OECD Secretariat (15 minutes)

Responses to the presentation

- **Mr. Steve Brereton**, Director, Investment Trade Policy Division, Department of Foreign Affairs and International Trade, Canada (10 minutes)
- **Ms. Pimchanok Vonkhornporn**, Head of Bilateral Services Negotiations Section, Department of Trade Negotiations, Ministry of Commerce, Thailand (10 minutes)

General discussion (30-35 minutes)

Wednesday, 26 May 2004

9:00-13:00 **Part II: Continuation**

9:00-10:10 **Session 4. Most-Favoured-Nation Treatment**

MFN treatment is one of the oldest standards of international economic relations. It is central to WTO disciplines and is as well a significant instrument of economic liberalisation in the investment field by spreading more favourable treatment from one investment agreement to another. The wording of MFN clauses varies, however, and their interpretation requires a close examination, on a case-by-case basis, in accordance with the provisions of the Vienna Convention. A widely acceptable principle – the *ejusdem generis* principle – provides that an MFN clause can attract the more favourable treatment available in other treaties only in regard to the “same subject matter”, the “same category of matter”, or the “same class of matter”. Past arbitral findings show, however, that the application of this principle has not always been simple or consistent. The session will review the jurisprudence and discuss avenues that can be used to reduce uncertainty in this area.

Presentation

Ms. Marie-France Houde, Senior Economist, OECD Secretariat (15 minutes)

Responses to the presentation

- **Mr. Johannes Bernabe**, Commercial Attache, Philippine

Permanent Mission to the United Nations & Other International Organisations in Geneva, The Philippines (10 minutes)

- **Mr. Oscar M. Garibaldi**, Partner of Covington and Burling, United States (10 minutes)

General discussion (30-35 minutes)

10:10-10:55 **Session 5. International Investment Disputes: New Challenges**

The international arbitration system has rapidly expanded in recent decades and increasingly substituted for litigation in domestic courts to resolve international investment disputes. The investor-to-state dispute settlement provisions included in a great number of investment agreements have considerably increased the load of ICSID and the number of *ad hoc* arbitral tribunals convened under the UNCITRAL rules. At the same time, several elements of a classic judicial system are considered to be lacking from the international arbitration system, such as: appellate or other control mechanisms and comparative uniformity of decisions. A number of issues such as transparency, multiple and conflicting awards on the same or similar facts and enforcement of previously annulled awards, add to the picture of a system that currently works but raises some new questions. Participants at this session will be invited to exchange views on these questions.

Presentations

Mr. Gonzalo Flores, Senior Counsel, International Centre for Settlement of Investment Disputes, ICSID (15 minutes)

Commentary

Ms. Eugenia Kontogiannopoulou, Legal Adviser, Ministry of Economy and Finance, Greece, and Chair of an Ad Hoc Group of Legal Experts of the OECD Investment Committee (10 minutes)

General discussion (20 minutes)

10:55-11:15 **Coffee break**

11:15-13:00 **Part III. APEC-OECD Co-operation on International Investment**

11:15-12:15 **Chair: Mr. Shigeo Matsutomi**, Chair of the CIME Advisory Group on Non-Members and Co-Chair of the OECD Task Force on a Policy Framework for Investment

OECD and APEC economies are major driving forces of, and close partners in, the world economy. Promoting investment and maximising its benefits are central to their respective mission to achieve sustainable growth and prosperity for their people. Both organisations are actively working with their members to improve their investment regimes, share experiences on good practices, conduct self evaluation and peer reviews, and built capacity for reform. The third part of the seminar will discuss the complementarities and synergies to be

exploited in the implementation of the Bogor Goals, the APEC Investment Principles, the OECD Declaration on International Investment and Multinational Enterprises and its newly launched “Investment for Development Initiative” and work on the development of a Policy Framework for Investment.

Presentations

Mr. Rainer Geiger, Deputy Director of the OECD Directorate for Financial and Enterprise Affairs, on **OECD Initiative on Investment for Development** (15 minutes)

Mr. Julio Bravo, APEC IEG Secretary, on **APEC Investment Principles and Action Plans** (15 minutes)

Commentary

Mr. Alan Bowman, APEC CTI Chair

General Discussion (20 minutes)

12:15-12:30 **Closing Remarks by Mr. Alan Bowman**, APEC CTI Chair

Acknowledgements

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