PART II. SURVEY OF IIA PROVISIONS AND COMMENTARY

Chapter 4

Provisions Defining the Scope of IIA Application and Other Preliminary Matters

4.1 Introduction

In preparing the Guide, a wide variety of IIA models were studied, including the model agreements used by:

- United Kingdom – UK Model Investment Promotion and Protection Agreement (IPPA);[1]
- India – Indian Model Bilateral Investment Promotion and Protection Agreement (BIPPA);[2]
- Canada – Canadian Model Foreign Investment Promotion and Protection Agreement (FIPA);[3]
- USA – US Model Bilateral Investment Agreement (BIT);[4] and
- Norway – Norwegian Draft Model Agreement on the Protection and Promotion of Investment (APPI).[5]

In addition, the model investment treaty proposed by the International Institute for Sustainable Development (IISD model treaty),[6] which contains a variety of features not found in any existing treaty, and the models proposed by the Asian–African

1 Model Investment Promotion and Protection Agreement, copy on file with the authors. The model was used with some variations in the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United Mexican States for the Promotion and Reciprocal Protection of Investments done at Vienna on 12 May 2006, in force 25 July 2007, UK Government, available at: www.official-documents.gov.uk/document/cm72/7218/7218.pdf (accessed 29 May 2012).

2 Indian Model Text of Bilateral Investment Promotion and Protection Agreement, online: Department of Economic Affairs, available at: http://finmin.nic.in/the_ministry/dept_eco_affairs/icsection/Indian%20Model%20Text%20BIPA. asp (accessed 29 May 2012).

3 Canada's New Model Foreign Investment Promotion and Protection Agreement, available at: www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/2004-FIPA-model-en.pdf (accessed 29 May 2012).

4 2012 US model BIT, available at: www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf (accessed 29 May 2012).

5 Norwegian draft model APPI (19 December 2007), copy on file with the authors. In June 2009, following extensive consultations, the Norwegian government announced that it would not proceed to finalise a new model agreement.

6 H Mann, K von Moltke, LE Peterson and A Cosbey (2005), IISD Model International Agreement on Investment for Sustainable Development, International Institute for Sustainable Development, Winnipeg, available at: www.iisd.org/pdf/2005/investment_model_int_agreement.pdf (accessed 29 May 2012).

Legal Consultative Committee (AALCC models) were studied.[7] A large number of existing IIAs were also reviewed, including some of the IIAs entered into recently between developing countries, such as the Investment Agreement for the COMESA Common Investment Area[8] (COMESA Investment Agreement), the ASEAN Comprehensive Investment Agreement[9] (ASEAN Agreement) and the investment chapter of the India–Singapore Comprehensive Economic Cooperation Agreement (India–Singapore CECA).[10]

Reference is made to these various models and existing IIAs in the discussion of specific provisions included in the Guide. One of the purposes of doing so is to identify the source of the provisions being discussed; another is to allow countries negotiating IIAs to use precedents that have been endorsed by other countries in support of their negotiating position. All of the existing treaties referred to in the Guide are listed in the List of Treaties set out at the beginning of the Guide.

4.2 IIA preambles

Cross reference

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4.2.1 The role of preambles in IIAs

A preamble to an IIA consists of statements at the beginning of the agreement expressing the parties' general intentions and goals in entering into the treaty. While it does not create or limit obligations in the treaty directly, the interpretation of obligations and their application in particular situations will be informed by the compatibility of the interpretation or application with the preamble. Those interpreting the treaty, including investor–state tribunals, should prefer the interpretation that best achieves the goals set out in the preamble and is otherwise consistent with it.

The relevance of the preamble for interpreting the obligations contained in an IIA is confirmed by the *Vienna Convention on the Law of Treaties* (*Vienna Convention*), which provides the basic framework for interpreting international treaty obligations.[11]

7 The treaty models were proposed by the Asian–African Legal Consultative Committee in the 1980s and are available at: www.aalco.int/PROMOTION%20AND%20PROTECTION%20OF%20INVESTMENTS.pdf (accessed 26 April 2012). UNCTAD (2007), *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking*, United Nations, New York and Geneva, provides a comprehensive review of IIA provisions from around the globe.

8 The Twelfth Summit of COMESA Authority of Heads of State and Government, held in Nairobi, Kenya, 22–23 May 2007, adopted the Investment Agreement for the COMESA Common Investment Area (CCIA). COMESA stands for the Common Market for Eastern and Southern Africa.

9 Association of Southeast Asian Nations, Comprehensive Investment Agreement, signed 26 February, 2009, in force 29 March 2012.

10 Investment Chapter of the Comprehensive Economic Cooperation Agreement Between the Republic of India and the Republic of Singapore, signed 29 June 2005, in force 1 August 2005.

11 *Vienna Convention on the Law of Treaties,* signed 23 May 1969, 1155 *United Nations Treaty Series* 331, reprinted in 8 *International Legal Materials* 679, signed 23 May 1969, in force 27 January 1980.

Article 31(1) of the *Vienna Convention* requires, in part, that treaty provisions be interpreted in light of their context. A treaty must 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 light of its object and purpose. (Emphasis added.)

The *Vienna Convention* goes on to define the context as consisting of the preamble as well as the treaty text and any annexes to the treaty.[12] Consistent with the *Vienna Convention*, all provisions in a treaty, including reservations and exceptions, must be interpreted in light of the expressly stated objectives of the treaty, which may appear in the preamble. Any other statements in the preamble form part of the interpretive context.

4.2.2 Use and interpretation of preambles in IIA practice

Where they have preambles at all, most IIAs refer only to protecting and attracting investment. For example, in the Indian model agreement, the preamble states:

> Desiring to create favourable conditions for greater investment by investors of one Contracting Party in the territory of the other Contracting Party;
>
> Recognising the reciprocal protection of investments under this agreement would foster individuals using initiative and will increase prosperity for both states;
>
> Have agreed as follows:[13]

Other preambles identify a more expansive set of goals. In the preamble of the India–Singapore CECA, for example, the parties recognise 'their right to pursue economic philosophies suited to their development goals and their right to regulate activities to realise their national policy objectives'. Other IIA preambles also affirm the party states' right to regulate.[14] Some mention specific policy objectives such as sustainable development and the party states' commitment to human and

12 Tribunals rendering decisions in investor–state arbitrations under Chapter 11 of the *North American Free Trade Agreement* (signed 17 December 1992, in force 1 January 1994, reprinted in (1993) 32 *International Legal Materials* 605) have sometimes accorded greater weight to the overall object and purpose of the agreement (e.g. *ADF Group Inc. v. the United States of America*, ICSID Case no. (AF)/00/1, Final Award, 9 January 2003, suggesting NAFTA should be interpreted 'in the context of the entire structure of NAFTA to understand the real shape and content of the bargain struck' (at para. 149)). Interpretation based on the true object and purpose of the treaty, which is sometimes referred to as a 'teleological approach', has been rejected in WTO cases by the Appellate Body in *Japan – Taxes on Alcoholic Beverages* (*Complaint by the European Communities, Canada and the United States*) (1996), WT/DS8, 10, 11/AB/R (Appellate Body Report). In *United States – Import Prohibition of Certain Shrimp and Shrimp Products (Complaint by India et al.)* (1998), WT/DS58/AB/R (Appellate Body Report), the Appellate Body expressly suggested that there is some scope for such an approach, though the approach actually applied in the case may be interpreted as consistent with the text based approach mandated by the *Vienna Convention*, op. cit.

13 Indian Model BIPPA, preamble. The UK model IPPA has almost identical language in its preamble.

14 E.g. Panama–Taiwan Free Trade Agreement, signed 21 August 2003, in force 1 January 2004.

labour rights, and environmental standards.[15] The preamble to the COMESA Investment Agreement, for example, reaffirms the importance to the parties of 'sustainable economic growth'.[16] The preamble of the ASEAN Agreement recognises the different levels of development of the member states and the need for 'special and differential treatment', as well as the link between investment flows and development.

How a preamble is drafted can have a significant effect on the way its various elements are used in interpreting the substantive provisions of the agreement. For instance, in the North American Free Trade Agreement (NAFTA),[17] a regional trade agreement among Canada, Mexico and the USA, the principal purpose of the agreement as stated in its preamble is to 'create an expanded and secure market for the goods and services produced in [the Party states'] territories'.[18] This statement has caused dispute settlement panels to narrowly interpret reservations and exceptions in NAFTA that limit the size or security of the market.[19] In NAFTA's preamble, the parties also resolve to 'preserve their flexibility to safeguard the public welfare'. This aspect of the preamble has not been relied on in cases decided under NAFTA's dispute settlement mechanisms because of the way it is expressed. Expanding and securing the market for goods and services is clearly identified as an objective of the agreement. In contrast, safeguarding the public welfare is not expressly referred to in the preamble as a positive objective of the agreement. Accordingly, it has been given less interpretive weight. This approach to interpretation of the different aspects of the NAFTA preamble is confirmed in a separate objectives provision, which states that the objectives of the agreement are to 'eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services' and to 'increase substantially investment opportunities'. Nowhere in the objectives provision is public welfare mentioned.[20]

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15 E.g. United States–Uruguay, Treaty between the United States of America and the Oriental Republic of Uruguay concerning the Encouragement and Reciprocal Protection of Investment, signed 4 November 2005, in force 1 November 2006; European Community–CARIFORUM Economic Partnership Agreement, signed 15 October 2008, in force 29 December 2008.

16 The COMESA Investment Agreement (2007) follows the IISD model treaty in this regard. See similarly the preamble to the Canada–Colombia Free Trade Agreement, signed 21 November 2008, in force 15 August 2011, and to the United States–Colombia Trade Promotion Agreement, signed 22 November 2006, in force 15 May 2012, as well as to the *Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects*, 17 December 1994, 34 *International Legal Materials* 446.

17 NAFTA (1992).

18 In *In the Matter of Cross-Border Trucking Services* (USA-Mex-98-2008-01), Final Report of the Panel, 6 February 2001, the panel noted that international tribunals in other contexts frequently refer to the preamble of a treaty for the purpose of determining the principal object of the treaty, in accordance with Article 31 of the *Vienna Convention*, citing *The Lotus* (1927), P.C.I.J. Ser. A, No.10, 17; *Free Zones of Upper Savoy and the District of Gex* (Order) (1929), P.C.I.J., Ser. A, No. 22, 12; *Asylum (Colombia, Perú)* (1950), ICJ Rep. 266, 276, 282 (at para. 219, note 233).

19 *Cross–Border Trucking*, ibid. This is consistent with the approach generally adopted in international jurisprudence. See J K Koh (1982), 'Reservations to Multilateral Treaties', 23 *Harvard International Law Journal* 71.

20 NAFTA (1992), Art. 102(1)(a).

This brief discussion illustrates two points regarding the role played by preambles in IIAs:

- **Preambles are an important part of the interpretive context and, if they are to be included in an IIA, careful thought must be given to the manner in which they are worded.** The wording will indicate the relative importance to be attributed to different objectives of the parties. It is desirable for the parties to clearly identify their most important considerations as objectives of the agreement.
- **The significance of preambles for interpreting an agreement may be affected by other provisions in the agreement, including objectives provisions.** Accordingly, it is important to ensure that any objectives provision reflects the same priorities as the preamble in order to maximise the likelihood of consistent interpretation. Otherwise, the objectives provision may be given priority over more general wording in the preamble.

Box 4.1 Summary of options for an IIA preamble

1. *No preamble*
2. *Preamble that refers only to investment promotion and protection*
3. *Preamble that refers to objectives beyond investment promotion and protection*

4.2.3 Discussion of options

1. *No preamble*

This is the most common practice in existing IIAs. Because a preamble is an important part of the interpretive context, not including one means that interpreters of the IIA have less direction regarding how its obligations should be interpreted. This leaves more discretion to the interpreter. Interpretive direction can be given through an objectives provision in the absence of a preamble.

2. *Preamble that refers only to investment promotion and protection*

This is the most common form of preamble in IIAs that have one. Because this form of preamble identifies only two objectives, the promotion and protection of investment, it prioritises these objectives for any interpreter of the agreement, including an investor–state tribunal. An interpreter might feel compelled to disregard other policy considerations that might be relevant. So, for example, if a state sought to regulate to protect the environment, this legitimate public purpose might be disregarded as a factor relevant to the application of the treaty to the measure. Interpretive direction in an objectives provision can qualify or complement the direction in a preamble. To ensure consistent interpretation, the objectives provision and the preamble should be consistent.

3. *Preamble that refers to objectives beyond investment promotion and protection*

In this form of preamble, found in some IIAs, the parties have an opportunity to identify and prioritise their intentions in entering into an IIA to include a broad range of considerations, including contributing to sustainable development. This helps to ensure that various policy priorities are taken into account by the interpreters of the treaty. The interpretive direction in such a preamble can be complemented by an objectives provision.

4.2.4 Discussion of sample provision

The sample preamble is much longer than those found in most existing agreements, with a view to setting out a vision of an IIA that goes beyond simply the promotion and protection of investment. Recognising the important interpretive role of the preamble, the sample preamble emphasises several goals that would inform an IIA designed to help achieve sustainable development. First, the preamble begins by setting out the pre-eminent objective of achieving sustainable development through increased foreign investment. This is emphasised and confirmed by the statement in the sample objectives provision set out below.[21] Next, the preamble recognises the significant role of two elements in achieving this objective: co-operation among the host state, the home state and investors, and the existence of favourable conditions for investment.

Other values inherent in a commitment to sustainable development and which are to inform interpretation of the parties' obligations are specifically identified: the protection of health, safety and the environment; the promotion and protection of internationally and domestically recognised human rights; labour rights; the rights of indigenous peoples; the commitment of the parties to democracy; the rule of law; and the parties' determination to prevent and combat corruption and to promote corporate social responsibility. The sample preamble also specifically refers to the right of party states to regulate to achieve their development objectives.

Drafting the preamble with such a fully elaborated description of what the parties are seeking to achieve should help to ensure that the reservations and exceptions in an IIA that are intended to preserve host states' ability to regulate in the public interest for the achievement of sustainable development are not interpreted in a restrictive manner, as has been done under NAFTA and in some other investor–state arbitration cases dealing with other IIAs.[22]

States should consider whether they want to include additional or different objectives from those set out in the sample preamble to reflect their own priorities and the specific context in which a treaty is being negotiated. In a regional treaty, for example, the

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21 See Section 4.4 (Statement of objectives).

22 E.g. the conclusion reached in *SGS v. Philippines*, ICSID Case no. ARB/02/06, Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004, that it is appropriate for a tribunal to resolve questions of interpretive doubt under a BIT in favour of the investor.

parties may want to include a reference to achieving regional integration.[23] In some negotiating contexts, countries may want a shorter, more focused set of objectives than is set out in the sample preamble.

4.2.5 Sample provision: preamble

AGREEMENT BETWEEN ——— AND ————

FOR THE PROMOTION AND PROTECTION OF INVESTMENTS

———————— and ————————, hereinafter referred to as the 'Parties'

Recognising that investment is critical for sustainable development, and understanding that the promotion of investment requires co-operative efforts by investors and both Parties, those that are host to investors and those that are their home states;

Seeking to encourage, create and maintain equitable and favourable conditions for investors of one Party and their investments in the territory of the other Party on the basis of equality and mutual benefit with a view to encouraging investment that contributes to sustainable development;

Seeking to ensure that investment is consistent with and facilitative of the protection of health, safety and the environment, the promotion and protection of internationally and domestically recognised human rights, labour rights and the rights of indigenous peoples;

Recognising that each Party has, in accordance with general principles of international law, the right to pursue its own development objectives and priorities and the right to take regulatory or other measures to ensure that development in its territory is consistent with the goals and principles of sustainable development and with other social and economic policy objectives, including the promotion and protection of human rights, labour rights, the rights of indigenous peoples, and the protection of the environment;

Reaffirming their commitment to democracy, the rule of law, human rights and fundamental freedoms in accordance with their obligations under international law, including the principles set out in the United Nations Charter, the Universal Declaration of Human Rights, customary international law and provisions of international agreements relating to the environment, human rights, labour rights and the rights of indigenous peoples binding on the Parties and desiring to have this Agreement interpreted in a manner consistent with these commitments;

Determined to prevent and combat corruption, including bribery, in international trade and investment and to promote corporate social accountability;

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23 E.g. the preamble to the COMESA Investment Agreement (2007) and the preamble to the Protocol on Finance and Investment of the Southern African Development Community, signed 18 August 2006, in force 16 April 2010.

Recognising that the provisions of this agreement shall be interpreted in a mutually supportive manner;

Have agreed as follows: …

4.3 Definitions

Cross references

Section 4.5	Scope of application	94
Section 5.6	Limitations on expropriation and nationalisation	152
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The definition provisions of an IIA are important for several reasons. First, definitions provide clear and predictable meanings for terms used in the agreement. Second and more importantly, definitions determine the scope of the agreement. As discussed above,[24] the key definitions in this regard are 'investor' and 'investment'.

From the perspective of investors, the definitions of these terms should be as broad as possible to ensure that their investments in the other state, however they are structured and regardless of the form or nature of their investment, receive the protection of the treaty. In contrast, a capital-importing state[25] will want to ensure that these definitions are targeted at the kinds of investments and investors that the state wants to attract by assuming IIA obligations and that it does not include categories of investors or investments of a particular kind that it does not want to protect. For example, if a state does not want to provide protection to foreigners from the other party state who are buying recreational property rather than investing in a business, it will need to reflect this in the definition of investment in the treaty or in some other way.

In addition, defining investment and investor establishes the scope of a host state's obligations and, as a result, the state's exposure to investor–state claims. As a consequence, a capital-importing state will want to make certain that it is comfortable assuming the substantive obligations in the IIA in relation to all the kinds of investments and investors that fit within the definition. This requires assessing the compatibility of the obligations undertaken regarding the defined categories of investment and investor with the host state's current domestic policies and policies

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24 See Section 3.2.2 (Specific examples of the interaction between IIA commitments and domestic investment policy).

25 In this section and throughout the Guide, the expressions 'capital-importing state' and 'capital-exporting state' will often be used. It is recognized that many states are both importers and exporters of capital. Such states have interests as capital exporters and capital importers and their approach to IIAs should reflect an assessment of their overall interests, balancing their interests as exporters and importers in each negotiation. For such states, references to 'capital-importing state' and 'capital-exporting state' should be understood to refer the interests that a state has as a capital importer and those that it has as a capital exporter.

that it can foresee pursuing in relation to those kinds of investments and investors in the future. Possible conflicts between domestic policy and protecting certain kinds of investors and investments are discussed in detail below.

Countries also use definitions to specify the territorial scope of their obligations and the extent to which obligations apply to sub-national governments. Examples of how these kinds of limitations may be addressed are provided in the sample provision below.

Definitions, other than 'investment' and 'investor', that are included in the Guide sample definitions are discussed in the sections of the Guide on the substantive treaty provisions in which the defined term appears. In actual IIA negotiations, the sample definitions in the Guide may need to be supplemented by definitions specific to the IIA being negotiated.

4.3.1 Definition of investment

Investment is a broad concept that can include a wide range of interests. One approach to defining investment for the purposes of an IIA is to limit investments to interests in enterprises that are carrying on some productive activity in the host state. In some trade agreements, such as *GATS*, a narrow enterprise-based approach is used. In relation to investments, the agreement applies only to a service supplied through a commercial presence, which is defined as a corporation or a branch of a corporation that is owned or controlled by suppliers from WTO member states.[26] It is possible to have a more expansive list of interests in enterprises that qualify as investments. In NAFTA, for example, equity and debt securities issued by an enterprise are included (NAFTA, Art. 1139).[27] The investment does not have to give the investor ownership or control of the enterprise. Most IIAs, however, define investments to include an even wider range of property rights, assets and interests that are not limited to interests in an enterprise.

Issue 1: General approach – should the definition be open or closed?

In a large proportion of IIAs, investment is defined in an open-ended manner to include virtually every possible kind of investment. For example, many agreements define investment as 'every kind of asset' owned or controlled directly or indirectly by an investor of another party state, followed by an illustrative, non-exhaustive list of assets.[28] More recently, some countries, such as Canada, have opted for a closed or exhaustive list of assets that qualify as investment, and have provided specific

26 *GATS* also applies to services supplied through non-investment modes: services supplied (i) across the border by a foreign supplier to a consumer in another country, (ii) to a consumer who travels to the supplier's jurisdiction and (iii) though a services supplier who enters the consumer's jurisdiction. See the discussion of *GATS* in Appendix 2.

27 NAFTA (1992), Art. 1139.

28 E.g. Indian model BIPPA, Art. 1(b); US model BIT, Art. 1; UK model IPPA, Art. 1(a); Norwegian draft model APPI, Art. 2; ASEAN Agreement (2009), Art. 4; Sri Lanka–India, Agreement between the Government of the Democratic Socialist Republic of Sri Lanka and the Government of the Republic of India for the Promotion and Protection of Investment, signed 22 January 1997, in force 13 February 1998; India–Bangladesh, Bilateral Investment Promotion and Protection Agreement, signed 9 February 2009, in force 7 July 2011. The COMESA Investment Agreement (2007) simply refers to 'assets' followed by an indicative list and some exclusions (Art. 1.9).

exclusions from the definition.[29] Typically, the exclusions are intended to clarify the meaning of investment rather than to adopt a narrow or restrictive meaning. The IISD model treaty also contains a closed list definition, but it is much narrower in scope. For example, it excludes all portfolio investment.[30] The use of a closed definition and of exclusions allows states to ensure that IIA commitments are more precisely targeted at particular kinds of investments – those they want to attract.

As indicated above, capital-exporting states have usually favoured open definitions, because such a definition covers the widest range of investments by its investors. Investor arbitration tribunals have interpreted such definitions broadly, as appears to be intended, to include any kind of asset, including assets that are not normally considered an investment, such as money in a bank account and claims related to ordinary commercial transactions.[31] Because of this broad interpretation, open definitions provide the greatest reassurance to investors that their interests will be eligible for protection regardless of the form or nature of their investment. In addition, investments vary tremendously in their form and effect, and any limiting criteria that are imposed will inevitably be somewhat arbitrary.

However, from a host state's point of view, an open definition has several disadvantages:

- **Some of kinds of assets that will be eligible for protection will not produce the benefits commonly associated with investment, such as increased local employment and technology transfer, and will make little or no contribution to development;**
- **The scope of an open definition is inherently unpredictable, so states will find it difficult to determine what foreign interests qualify for protection and to ensure that they act consistently with their obligations; and**
- **With an open definition, protection will be extended to some kinds of investments that may not be attracted by the protection of an IIA.**

Regarding the last point, investments in sectors such as the extractive industries involve high sunk costs and are more likely to be the subject of regulatory action. Investors in these sectors may be more concerned about the risk of adverse action by a state because, typically, they have substantial effects on the local community in which they operate that may be the subject of state standards. Also, these kinds of investments must be in place for a long time before they become profitable, increasing the likelihood that state policy may change and new, possibly more onerous rules for the investment will be put in place. By comparison, IIA protection is less likely to attract investments that have no sunk costs or in relation to which the risk of government interference is low because they have little local effect and are of short duration, such as bonds and other financial investments. Investors with these kinds of investments are likely to be less interested in IIA protections from government interference.

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29 Canadian model FIPA, Art. 1.

30 IISD model treaty, Art. 3(C).

31 *SGS v. Philippines*, op. cit.

Some kinds of investments may be sufficiently mobile for investors to be able to move their capital out of the host state to avoid state actions that they do not like. It may be easier to withdraw a financial investment from a host country following some local government action, as compared with a direct investment. For example, in most cases it will be easier to dispose of a corporate bond issued by a business in a host state than an unfinished factory. In addition, for some financial investments, country-specific risks may be reduced for an investor where the investor has a large number of diversified investments in different countries. If an IIA does not contribute significantly to reducing the risks associated with host state actions for an investor with particular kinds of investments, it will not encourage investors to make such investments. At the same time, the inclusion of these categories of investment in an IIA definition of investment expands the host state's obligations and its risk of investor–state claims.

For all these reasons, host states may opt for a closed definition. UNCTAD has identified the use of closed definitions as an 'emerging trend'.[32] The issue then becomes what assets should be included. This issue is also relevant, however, if an open definition is used, since even an open definition may have criteria that must be satisfied for an investment to be eligible for IIA protection and it may exclude certain investments from its scope. Ultimately each state must resolve this issue on the basis of its domestic policy, but there are a number of common issues that will need to be taken into account in limiting the scope of an IIA definition of investment. These are discussed in the next sections.

Issue 2: What specific identified assets should be included (or excluded) in a definition of investment?

Whether the definitions are expressed to be open or closed, most contain a list of assets that are considered investments. The list in the German model BIT is typical:

I. Movable and immovable property as well as any other rights in rem, such as mortgages, liens and pledges;

II. Shares of companies and other kinds of interest in companies;

III. Claims to money that has been used to create an economic value or claims to any performance having an economic value;

IV. Intellectual property rights, in particular, copyrights, patents, utility-model patents, industrial designs, trademarks, trade names, trade and business secrets, technical processes, know-how, and good will; and

V. Business concessions under public law, including concessions to search for, extract and exploit natural resources.[33]

While this kind of listing is common, it raises a number of issues that countries must consider, including whether the definition should be limited to particular classes of

32 UNCTAD (2011), *Scope and Definition: A Sequel*, United Nations, New York and Geneva, at 114.
33 See the similar definition in the India–Singapore CECA (2005), Art. 6.1.

assets, how this should be done and whether there should be general limitations on what constitutes an investment.

Issue 2(a): Should the definition of investment be limited to foreign direct investment?

Foreign direct investment typically refers to transactions in which a foreign party obtains a lasting interest in some entity in the host country economy. It generally involves a long-term relationship and a significant degree of influence over the management of the entity.[34] Given the substantial investor protection obligations typically undertaken in an IIA and the prospect that they may be enforced through investor–state dispute arbitration, a state may prefer to limit the definition to interests that involve the characteristics of a direct investment. Many definitions, however, capture investments that do not have the attributes of foreign direct investment. For example, a definition may extend the protections in the agreement to short-term or highly mobile forms of investment that the host state is not interested in attracting.

Should an investment be required to have the 'characteristics of an investment'? One limiting approach adopted in some treaties is to require that an investment have the characteristics of an investment. For example, the US model BIT defines investment as follows.

> 'Investment' means every asset that an investor owns or controls, directly or indirectly, that has the *characteristics of an investment*, including such characteristics as the *commitment of capital or other resources*, *the expectation of gain or profit*, *or the assumption of risk* …[35] (Emphasis added.)

The ASEAN Agreement takes a similar approach.[36] This approach has several advantages. It goes some way towards ensuring that the economic contribution of the investment is substantial because it requires interpreters of the treaty to look at the economic characteristics of the investment, not just its formal characteristics, and provides some objective criteria to distinguish investments from ordinary commercial transactions. Nevertheless, how this sort of definition will apply in practice is hard to predict for several reasons:

- **The characteristics of an 'investment' in this kind of definition are not exhaustive.** It remains to be seen if other criteria may be developed in investor–state cases.

34 OECD (1996), *OECD Detailed Benchmark Definition of Foreign Direct Investment*, 3rd ed (BD3), OECD, Paris. Investors have used creative legal mechanisms to disguise portfolio investment as FDI in order to avoid capital controls and so states will need to incorporate language to address this if they wish to limit their IIAs to FDI.

35 US model BIT, Art. 1. A similar definition can be found in many agreements, e.g. India–Malaysia Comprehensive Economic Cooperation Agreement, signed 18 February 2011, in force 1 July 2011.

36 In a footnote to the definition of investment, the ASEAN Agreement provides as follows: 'Where an asset lacks the characteristics of an investment, that asset is not an investment regardless of the form it may take. The characteristics of an investment include the commitment of capital, the expectation of gain or profit, or the assumption of risk'.

- **It is not clear what the identified criteria mean.** The following questions about the definition remain unanswered: (i) does a commitment of any amount of capital qualify as an investment or is there a minimum threshold? (ii) if so, what is the threshold? and (iii) if an investment involves an assumption of risk, how should this risk be assessed? In some investor–state arbitrations under the Convention on the Settlement of Investment Disputes (the ICSID Convention),[37] tribunals have applied similar criteria to those in the US model to define investment for the purposes of the treaty and the results have been inconsistent.[38] The interpretation and significance of the ICSID definition of investment is discussed in Box 4.2.
- **In the definition used in the US model BIT, it is sufficient if any one of the criteria is satisfied.** An investment meets the requirements of the definition if it 'has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, *or* the assumption of risk'. While, in most practical circumstances, it seems likely that an investment with one of the characteristics would also have the other two, the fact that the criteria are not cumulative makes their application less certain. Some treaties use a cumulative formulation to address this uncertainty.[39]

Should an investment be required to contribute to development in the host state? An issue related to the definition of investment is whether only investments that make some contribution to development should be protected. From a developing country point of view such a requirement might seem to be a useful way to target the commitments being undertaken in the treaty so that they encourage only those investments that will provide development benefits. Including a 'contribution to development' requirement in the definition of investment also indicates clearly that the treaty's goal of protecting investment must be balanced with the goal of ensuring that the treaty meets the expectations of capital-importing states that investment benefiting from the treaty will contribute to their development. Such a provision would complement and reinforce the statements in the preamble, and the objectives provisions to the same effect.[40] In the event of an investor–state claim, the presence of such a requirement would permit a respondent state to challenge the jurisdiction

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37 *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, signed 18 March 1965, 575 *United Nations Treaty Series* 159, reprinted in 4 *International Legal Materials* 532. ICSID dispute resolution is commonly provided for in IIAs. See Section 7.1 (Investor–state dispute settlement). ICSID also refers to the institution that administers arbitrations and other procedures under the ICSID Convention, the International Centre for the Settlement of Investment Disputes.

38 See the survey of the case law in UNCTAD (2011), *Scope and Definition*, op. cit., at 48–65.

39 E.g. Belgium–Luxembourg–Colombia, Agreement between the Belgium–Luxembourg Economic Union, on the one hand, and the Republic of Colombia, on the other hand, on the Reciprocal Promotion and Protection of Investments, signed 4 February 2009, not yet in force, Art. I(2.3); Bilateral Agreement for the Promotion and Protection of Investments Between the Republic of Colombia and ___________, Colombian model agreement (2007), Art. 2.3.

40 See Section 4.2.1(The role of preambles in IIAs) and Section 4.4 (Statement of objectives).

of an arbitral tribunal to hear an investor's claim on the basis that the investment did not contribute to development.

Undoubtedly, however, a 'contribution to development' criterion would be difficult for both states and investors to interpret. In addition to the general uncertainty regarding what a contribution to development is, there will be situations in which both the investor and the host state expect an investment to contribute to development, but it fails to do so in practice. In the context of investor–state arbitration, a tribunal would have to deal with conflicting views regarding whether a contribution to development existed. The tribunal's job would be complicated by the fact that development, as discussed in Section 2.3, is not just a legal concept, but also has economic and social dimensions.

Some commentators have expressed the view that there is no need to include 'contribution to development' in the definition of investment because if the investment meets the other criteria mentioned above (commitment of capital or other resources, the expectation of gain or profit and the assumption of risk), it will necessarily contribute to development. However, not all tribunals have followed this approach.[41]

As discussed in Box 4.2, the 'contribution to development' criterion has sometimes been applied in cases under the ICSID Convention,[42] even where it does not appear in the IIA under consideration. This has occurred because an ICSID tribunal has jurisdiction only if the dispute arises out of an 'investment', and some tribunals have considered a contribution to development to be an essential characteristic of an investment. In the ICSID cases to date, tribunals have found it challenging to determine whether an investment does make a contribution to development.

As a consequence of the uncertainty relating to the concept of development, the availability of the protections of the treaty would become less certain for investors and host states if it were part of the definition of investment. It is probably impossible to draft a definition of investment that sets out clear and specific criteria capable of limiting the scope of the treaty to investments that promote sustainable development.

An alternative to including a requirement that the investment must contribute to sustainable development in the definition of investment is to limit the protection of the treaty to investments that have been approved by the host state and to have the host state evaluate the investment's contribution to development as a condition of approving it. If a state has the capacity to make such an assessment, there is less need to include such a requirement, with its attendant uncertainty.

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41 R Dolzer and C Schreuer (2008), *Principles of International Investment Law*, Oxford University Press, Oxford, at 69.

42 *ICSID Convention*, op. cit.

Box 4.2 The requirement for an 'investment' under Article 25 of the Convention on the Settlement of Disputes between States and Nationals of other States

About two-thirds of all investor–state arbitrations take place under the rules of the International Centre for the Settlement of Investment Disputes (ICSID). For a dispute between an investor and a state under an IIA to be dealt with under the procedures of the ICSID Convention, the investor must have made an 'investment' within the meaning of Article 25 of the Convention. Different tribunals have adopted different approaches to determining whether this requirement is met.

There is some uncertainty about whether Article 25 requires a tribunal to apply a definition of investment that is independent of the definition of investment in the IIA that is alleged to have been violated. While some ICSID tribunals have found that the language used by the parties in their agreement determines whether there is an investment for the purposes of Article 25,[43] others have decided that the existence of an investment for the purposes of Article 25 depends on the fulfilment of criteria that are independent of the parties' agreement, as well as whatever definition they have agreed to in the treaty. One recent tribunal identified the following criteria as relevant.

> To summarize all the requirements for an investment to benefit from the international protection of ICSID, the Tribunal considers that the following six elements have to be taken into account:
>
> 1. a contribution in money or other assets;
> 2. a certain duration;
> 3. an element of risk;
> 4. an operation made in order to develop an economic activity in the host State;
> 5. assets invested in accordance with the laws of the host State;
> 6. assets invested *bona fide*.[44]

Some ICSID cases have also required that the alleged investment make a contribution to the host state's development in order for it to be considered an

(Continued)

43 E.g. *MCI Power Group LC and New Turbine Incorporated v. Ecuador*, (2007) ICSID Case No. ARB/03/6, IIC 296, Award. 26 July 2007.

44 *Phoenix Action Limited v. Czech Republic*, ICSID Case No. ARB/06/5, IIC 367, Award, 15 April 2009.

(Continued)

investment for the purposes of Article 25,[45] though in other cases this approach has been specifically rejected.[46]

Since the decisions of ICSID tribunals are not binding on subsequent tribunals, it is impossible to predict with certainty whether: (i) a tribunal in an ICSID arbitration will require that these kinds of objective criteria for the existence of an investment must be satisfied regardless of what the parties have agreed to in their treaty; and (ii) if such objective criteria are applied, a contribution to development will be required.[47]

The implications for drafting IIAs are:

- States should not rely on definitions of 'investment' adopted in arbitration awards. If they wish to ensure that a specific criterion will be used to define whether an investment is eligible for protection, regardless of whether the treaty provides for ICSID arbitration or not, that criterion should be put into the treaty definition of investment.
- Even specific criteria may be interpreted in surprising ways, so it is best to be as clear as possible in defining investment in an IIA.
- If an IIA provides for ICISD arbitration, regardless of what the IIA says, an arbitral tribunal may adopt additional criteria for the purpose of determining whether or not the requirements for an investment under Article 25 have been met.

Making such an assessment, however, will often be a challenge for host countries. To respond to this problem, the Guide includes a discussion of best practices in the area of assessing investments. For instance, it describes provisions that require investors to engage in assessments of the environmental, social and human rights impacts of their investments prior to implementing them and to provide the assessment to the host country government for review with the goal of developing a management plan for the implementation of the investment that is designed to ensure its compatibility with sustainable development.[48] The Guide also discusses the use of technical assistance provisions to support the development of the capacity of developing countries to assess the costs and benefits of foreign investment.[49]

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45 *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Jordan*, ICSID Case No. ARB/02/13, IIC 208, Award, 31 January 2006.

46 *Biwater Gauff v. Tanzania*, ICSID Case No. ARB/05/22, Award, 24 July 2008, at para. 312; *Malaysian Historical Salvors v. Malaysia*, (2009) ICSID Case No. ARB/05/10, Annulment Decision, 16 April 2009.

47 Some non-ICSID tribunals have applied objective criteria for the existence of an investment in determining their own jurisdiction, for example *Romak S.A. v. Uzbekistan*, PCA Case No AA280, Award, 26 November 2009, at para. 207; and *Mytilineos Holdings S.A. v. The State Union of Serbia and Montenegro and Republic of Serbia*, UNCITRAL, Partial Award on Jurisdiction, 8 September 2006 at paras 117–125.

48 See Section 6.6 (Sustainability assessments).

49 See Section 8.2 (Technical assistance).

Issue 2(b): Should portfolio investment be excluded?

Another way to narrow the definition of investment so that it includes only significant investments that contribute to development is to create specific exclusions for investments that do not satisfy these requirements. Some suggest that portfolio investment should be excluded on this basis.

Considerations related to whether portfolio investment should be included in an IIA definition of investment As noted above, most treaties use a broad definition of investment that includes what is referred to as portfolio investment, meaning investment in debt and equity securities that is intended only for financial gain and that does not create a lasting interest in or control over an enterprise. Portfolio investors are passive and do not have the ability to manage the business in which they have invested. Examples of portfolio investments are purchases of bonds and stocks that do not give the investor control over the issuer of the securities. Several arguments can be made in favour of excluding portfolio investment from investments protected under an IIA. These arguments parallel those made above in support of a definition of investment that is limited to investments that have the characteristics of an investment.

- **The exclusion of portfolio investment helps to ensure that only substantial investments that make a significant contribution to the host country economy would benefit from IIA protection, including access to investor–state dispute settlement.**[50] Portfolio investment does not generally produce the kinds of benefits attributed to direct investment, such as technology transfer.[51]
- **Portfolio investment is highly volatile and rapid swings in investment flows can be damaging to a host state.** For this reason, a definition of investment should not be targeted at portfolio investment. It is not a category of investment that states should seek to attract.
- **Protecting portfolio investment under an IIA increases the risk of investor–state cases by expanding the class of persons eligible to make claims.**
- **Portfolio investment does not need the protection of IIA investor protection commitments and will not be encouraged by such commitments:**
    - Portfolio investors are often able to reduce their country-specific risk by diversifying their investment holdings to include investments in many countries; and

50 The exclusion of portfolio investment in the IISD model was intended to ensure the achievement of this objective. As discussed below, under the IISD model investors also have obligations and for this reason as well the drafters decided that it would be impractical to include portfolio investment in the definition of investment (H Mann, K von Moltke, LE Peterson and A Cosbey (2005), IISD Model International Agreement on Investment for Sustainable Development, International Institute for Sustainable Development, Winnipeg, at 6).

51 UNCTAD (2011), *Most Favoured Nation: A Sequel*, United Nations, New York and Geneva, at 29.

- Portfolio investors are more likely to be able to recover the value of their investments and withdraw them from a host country if the host country acts contrary to their interests, compared with investors who have acquired ownership or control of real property, plants and equipment in the host country. Portfolio investors are less likely to have sunk costs that would require them to continue to hold their investments in the face of adverse host state action.

On the other hand, portfolio investment may be attractive to host countries and their businesses because it can make a contribution to sustainable development, at least in some cases. Even though the inclusion of portfolio investment extends treaty protection to many relatively small investments, the aggregate benefit of such investments to investors of the home state may be substantial and complementary to other sources of capital.[52] Successful direct investments may require other types of capital flows, including portfolio investment.[53] In addition, portfolio investment in locally owned businesses may be attractive because it permits the control of the business to remain in the hands of host state nationals.

The risk of multiple claims by portfolio investors with investments in the same business may be mitigated in practice because the costs for an individual investor to bring an investor–state claim, even if the investor's claim is ultimately successful, are so large that many possible claims by small investors may never be brought. This impediment will not operate, however, where many small investors with identical claims can pool their resources to bring a claim.[54] This might occur where there are multiple minority foreign holders of shares of a corporation carrying on business in a host state or multiple holders of bonds issued by such a corporation and all these investors are affected in the same way by host state actions.[55]

Defining portfolio investment in an IIA One of the challenges of excluding portfolio investment is how to define it, causing some to question the practicality of excluding it.[56] It is difficult to create a definition of portfolio that can be applied in a consistent and predictable way. One approach that has been used in some agreements has been

52 WTO Working Group on the Relationship between Trade and Investment, Note by the Secretariat, WT/WGTI/W/108, paras 50–54 (21 March 2002).

53 Ibid.

54 See, for example, 107 identical claims by individual members of the Canadian Cattlemen for Fair Trade as one claim, available at: www.state.gov/s/l/c14683.htm (accessed 29 May 2012).

55 E.g. *Abaclat and others v. Argentine Republic*, (2011) ICSID Case No. ARB/07/05, Decision on Jurisdiction and Admissability, 4 August 2011. One way to address the process costs of multiple identical investor–state claims is to provide a process for their consolidation. This is discussed below. See Section 7.1 (Investor–state dispute settlement). While consolidation of multiple similar or identical claims reduces the cost for states of defending them, the possibility of consolidation may deter investors from making claims.

56 Association of Southeast Asian States, Framework Agreement on the ASEAN Investment Area, signed 7 October 1998, excludes portfolio investment, but does not define it (Art. 2). The current ASEAN Agreement (2009) contains no such exclusion. The SADC Investment Protocol (2006) contains a proviso permitting each party state to exclude 'short-term portfolio investments of a speculative nature' but provides no further definition (Art. 1).

to limit the coverage of the IIA to foreign direct investment, which would have the effect of excluding portfolio investment.[57]

The OECD Benchmark Definition of Foreign Direct Investment[58] was produced by the Working Group on International Investment Statistics, representing the international community of FDI statisticians. Its purpose is to provide a definition of FDI that can be applied consistently by national statistical agencies. It is more than 200 pages long, but the basic definition is as follows:

> Foreign direct investment (*FDI*) is a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (*direct investor*) in an enterprise (*direct investment enterprise*) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship.[59]

The definition in the IMF's *Balance of Payments and International Investment Position Manual* takes an identical approach. The IMF *Manual* defines portfolio investment, essentially, as anything that is not FDI.[60]

Even though the 10 per cent threshold in the OECD definition is arbitrary, in that some investments of less than 10 per cent will represent a significant degree of influence and some investments of greater than 10 per cent will not, it is used without exception for statistics gathering in the interest of consistent reporting. The same consideration does not apply in the context of a definition in an IIA. Nevertheless, in the absence of any other specific criterion, 10 per cent of voting shares in a corporation or other forms of ownership may be a useful way to define when an investment is no longer a portfolio investment, because compared with the other main criteria – a lasting interest – the 10 per cent threshold is more certain and predictable.

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57 E.g. the Canada–United States Free Trade Agreement, signed 2 January 1988, in force 1 January 1989, Art. 1611; European Free Trade Association–United Mexican States Free Trade Agreement, signed 27 November 2000, in force 1 July 2001, Art. 45; and Denmark–Poland, Agreement between the Government of the Kingdom of Denmark and the Government of the Republic of Poland for the Promotion and Reciprocal Protection of Investments, signed 1 May 1990, in force 13 October 1990, Art. 1(1)(b). A similar approach is taken in the IISD model treaty, though the definition goes on to specify certain additional characteristics of an investment for the purposes of the agreement (Art. 2).

58 OECD (2008) *OECD Benchmark Definition of Foreign Direct Investment*, 4th ed, OECD, Paris.

59 Ibid., at 234.

60 IMF (2007), *IMF's Balance of Payments and International Investment Position Manual*, 6th ed, IMF, Washington, paras 6.8 to 6.24. The definition of portfolio investment in the *IMF Manual* essentially says that portfolio investment is anything that is not direct investment or reserve assets (para. 6.54). UNCTAD uses a similar definition. See UNCTAD (1996), *World Investment Report 1996*, United Nations, New York and Geneva, at 219.

As defined in the IMF *Manual*, the threshold includes interests that are held directly by an investor, as well as indirectly through an interest in an intermediary entity such as a corporation wholly owned by the investor. Determining the effective size of an interest held through several intermediary entities can be complex. Debt and other claims that do not involve the power to vote are not generally considered a direct investment relationship, unless a direct investment relationship otherwise exists between the parties through other forms of investment.[61]

Based on this discussion, 'portfolio investment' could be defined as follows for the purpose of excluding it from the definition of investment in an IIA.

> Portfolio investment has the meaning given to that term from time to time in the IMF's *Balance of Payments and International Investment Position Manual.*

This definition has the benefit of relying on a well-recognised and widely used international standard. However, the definition is subject to change over time as the IMF Manual is revised, and the manual definition is nuanced and complex to apply in practice.

Another approach would be the following:

> Portfolio investment is any investment that is an equity security or a debt security in an enterprise that does not give the investor a lasting interest in the enterprise or direct or indirect ownership of 10 per cent or more of the voting power of an enterprise.

This definition adopts the essence of the IMF and OECD definitions. The concept of 'lasting interest' is inherently flexible and requires a degree of judgment that could lead to a degree of unpredictability with respect to what it means. For example, it is not clear whether certain debt securities that impose requirements on management to maintain specific financial standards, and become voting securities if management fails to do so, would give a significant degree of influence to the investors such that they should not be considered portfolio investment. The additional requirement of less than 10 per cent of the voting power is somewhat arbitrary, but is more certain and predictable.

Issue 2(c): Should debt and other claims to money be excluded?

As in the German model agreement, most IIAs include 'claims to money which has been used to create an economic value or claims to any performance having an economic value' in their definition of investment.[62] This expression would include most debts and even some claims under commercial contracts. Because both of these kinds of transactions are outside what would conventionally be considered an investment, some IIAs contain limitations that narrow the scope of the definition of an investment to exclude them to some extent. There are two main approaches:

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61 *IMF Manual* at para. 6.37. Some exceptions are provided.

62 M Malik (2009), *Report on Bilateral Investment Treaties*, Commonwealth Secretariat, London, at 7.

- **Claims to money are included only if they are linked to some more conventional kind of investment that fits within the definition of investment in the agreement.** Some IIAs entered into by Caribbean countries, for example, limit loans to those that 'are directly related to a specific investment'.[63]

- **Certain claims to money are specifically excluded.** For example, the COMESA Investment Agreement excludes 'claims to money deriving solely from commercial contracts for the sale of goods and services to or from the territory of a member State' and 'a bank letter of credit; or the extensions of credit in connection with a commercial transaction, such as trade financing.'[64] The Canadian model agreement similarly excludes claims to money arising out of commercial contracts for the sale of goods or services between national enterprises in different party states. The Canadian model also excludes financial transactions that do not involve the acquisition of property, as well as loans with a maturity of less than three years.[65]

The approach adopted in the COMESA Investment Agreement and the Canadian model has the advantage of being more specific and predictable for the benefit of both host states and investors. The exclusion of loans with a maturity of less than three years is an attempt to ensure that only loans that make a significant and stable financial contribution in a host country are protected as investments. Short-term investments are inherently more volatile. Nevertheless, a term of three years is somewhat arbitrary and may not be the optimal way to distinguish loans that support other kinds of investment activity.

A third approach is found in the US model agreement, which has a broad definition that includes claims to money, but adds the following footnote:

> Some forms of debt, such as bonds, debentures, and long-term notes, are more likely to have the characteristics of an investment, while other forms of debt, such as claims to payment that are immediately due and result from the sale of goods or services, are less likely to have such characteristics.

An investor–state arbitration tribunal would have to take this interpretative direction into account in determining whether an alleged investment has the characteristics of an investment as required by the US definition of investment. This approach might do a better job of targeting the definition at debt that supports investment, but it creates a greater degree of uncertainty than the other two approaches regarding how it would operate in practice.

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63 For example, Germany–Trinidad and Tobago, Treaty between the Federal Republic of Germany and the Republic of Trinidad and Tobago for the Encouragement and Reciprocal Protection of Investments, signed 8 September 2006, in force 17 April 2010, and Korea–Trinidad and Tobago, Agreement between the Government of the Republic of Korea and the Government of the Republic of Trinidad and Tobago for the Promotion and Protection of Investments, signed 5 November 2002, in force 27 November 2003, and others described in Malik, ibid., at 7–8.

64 COMESA Investment Agreement (2007), Art. 1.9.

65 Canadian model FIPA, Art. 1.

Issue 2(d): Should intellectual property be excluded?

Existing practice Most IIAs include intellectual property in their definition of investment, though how they do so varies.[66] One common approach is exemplified by the German model set out above, which defines investment to include:

> Intellectual property rights, in particular copyrights, patents, utility model patents, industrial designs, trademarks, trade names, trade and business secrets, technical processes, know-how and good will.

Some other IIAs simply refer to intellectual property without specifying what is meant, or identify categories of intellectual property rights without using the words 'intellectual property'.[67] The Canadian model, for example, refers simply to 'intangible property.'[68]

Issues related to the inclusion of intellectual property rights in an IIA Protecting the intellectual property rights of foreign investors can raise a number of difficult challenges for host developing countries and the additional protection of such rights through IIAs has been the subject of some criticism.[69] All countries that are members of the WTO must comply with the obligations of the Agreement on Trade-related Aspects of Intellectual Property (the TRIPs Agreement), which identifies categories of intellectual property and sets minimum standards for the rights associated with each category, as well as the enforcement of those rights. Many countries have entered into preferential trade agreements that impose further obligations. As a consequence, one challenge is to ensure that that any IIA provisions that a country agrees to are

66 For example, the following models define investment to include intellectual property, either explicitly or through open-ended definitions: Indian model BIPPA, Art. 1(b); US model BIT, Art. 1; Canadian model FIPA, Art. 1; UK model IPPA, Art. 1(a); Norwegian draft model APPI, Art. 2; COMESA Investment Agreement (2007), Art. 1.9; SADC Investment Protocol (2006), Art. 1; ASEAN Agreement, Art. 4(c); India–Singapore CECA (2005), Art. 6.1(1); India–Malaysia CECA (2011), Art. 1. The same is true for most Caribbean and all Pacific BITS (Malik, op. cit., at 8, 43). The IISD model treaty does not expressly refer to intellectual property rights, but the commentary indicates that the drafters intended the intellectual property rights could be protected where the right is associated with an investment otherwise defined. Stand-alone rights, including rights under a licence, are intended to be excluded (H Mann, et al. (2005), *IISD Model International Agreement on Investment for Sustainable Development – Negotiators Handbook,* International Institute for Sustainable Development, Winnipeg, at 6.). The IISD's distinction has not been adopted in the Guide sample provision because it is difficult to express such a distinction clearly and effectively. It is not obvious that the IISD model is successful in excluding stand-alone rights. Also, it may be desirable for local businesses to be able to access technology through such licences.

67 E.g. Germany–Antigua and Barbuda, Treaty between the Federal Republic of Germany and Antigua and Barbuda concerning the Encouragement and Reciprocal Protection of Investments, signed 11 May 1998, in force 18 February 2001.

68 Canadian model FIPA, Art 1.

69 C M Correa (2004), 'Bilateral Investment Agreements: Agents of New Global Standards for the Protection of Intellectual Property Rights?', available at: www.grain.org/briefings_files/correa-bits-august-2004.pdf (accessed 29 May 2012).

consistent with its obligations. Developing countries often find their international obligations related to intellectual property onerous and struggle to comply with them. Nevertheless, in general, IIA provisions do not conflict with intellectual property obligations, since IIAs do not prescribe specific levels of intellectual property rights protection. Instead, the broad investor protection obligations largely protect entitlements in intellectual property that are granted under domestic law.[70] Nevertheless, protecting intellectual property rights as investments under IIAs can create problems. The following are two examples:

- **Protecting the patents of foreign investors in pharmaceuticals as investments under an IIA may impede the host country's ability to grant access to medicines for the poor.** Granting a compulsory licence of a patented drug to a local company to produce a needed medicine at a lower price could be considered an expropriation of an investment requiring compensation under an IIA if the patent is held by a foreign investor eligible for protection under the IIA. This is a risk even though the TRIPs Agreement expressly permits compulsory licensing so long as certain criteria are met.[71]
- **Protecting intellectual property of foreign investors under an IIA may result in protecting entitlements beyond what is protected under domestic law.** Despite TRIPs and other international intellectual property agreements that set standards for what must be protected, what is actually protected as intellectual property varies somewhat from one country to another. Some IIAs include goodwill, technical processes, trade names and other forms of intellectual property within their definition of investment. These are not categories of intellectual property rights that are required to be protected under intellectual property treaties and may not be protected under domestic law. Nevertheless, if they are defined to be an investment under an IIA, a host state will be required to treat these kinds of rights and interests in a manner consistent with the protections in the agreement.

From an investor's point of view, intellectual property rights are often critically important because the value of their investments is determined by technology and other assets protected by such rights.[72] For this reason, and because it would be inconsistent with existing practice, total exclusion of intellectual property rights will be difficult to negotiate. Even if it were possible, a complete exclusion might have a negative impact on the success of the IIA in attracting investment. In addition, developing country businesses are increasingly exporters of intellectual property. Consequently, often the issue in IIA negotiations will be how to ensure that the scope for IIA protection is appropriate.

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70 E.g. *Eli Lilly v. Canada*, (2012), Notice of Intent, 7 November 2012, challenging aspects of Canada's patent law as not consistent with Canada's international obligations.

71 TRIPs Agreement, Art. 31. There may be defences that a state could raise to such a claim.

72 B Mercurio (2010), 'Reconceptualizing the Debate on Intellectual Property Rights and Economic Development', 3 *Law and Development Review* 64.

Options for narrowing the scope of intellectual property rights included in an IIA If intellectual property rights are to be protected as investments, a second set of issues relates to how broadly they will be protected. The following sets out several approaches to limiting the protection afforded.

- **Limiting protected intellectual property to rights that are connected to some other form of investment:** One issue for host states is whether intellectual property rights should be protected only when they are connected to some other form of investment in the host state or also on a stand-alone basis, such as in a licensing transaction unconnected to any other economic activity. Most agreements simply say that intellectual property rights are protected, which would apparently cover both situations. The COMESA Investment Agreement, however, provides that an intellectual property right has to be connected with an investment in the host state to be eligible for protection.[73] A host state might be concerned that protecting bare licences would extend protection to investors who have registered their rights but not contributed anything to the local economy. A patent on an industrial process that is not being worked by the foreign patent holder in the host country is one example. The patent holder could prevent others from using the patented technology even if they are not using it themselves. On the other hand, protection would encourage licensing of needed technologies to businesses operating in the host country.
- **Defining what is meant by intellectual property rights specifically:** A second issue is how broadly to define intellectual property rights. While some agreements include goodwill, technical processes, trade names, know-how and business secrets, as well as patents, copyrights, trademarks, industrial designs and utility models,[74] others do not define intellectual property rights at all[75] or exclude certain forms, such as goodwill.[76] In general, some definition of what is meant is helpful since what is intellectual property varies somewhat from state to state. Also, a state should consider to what extent it wants to agree in an IIA to protect categories of intellectual property that are not protected under its domestic law. The definition of investment in the India–Malaysia Comprehensive Economic Cooperation Agreement includes only intellectual property rights 'recognized pursuant to laws and regulations of each Party.'[77] Such an approach has the advantage of precluding an investor from making a claim under an IIA that is based on a conception of intellectual property not recognised in the host state.

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73 COMESA Investment Agreement (2007), Art. 1.9. The definition in the Canadian model FIPA states that intangible property is protected as an investment only to the extent that it is acquired in the expectation or used for the purposes of economic benefit or other business purpose (Art. 1). This would appear to be broad enough to capture stand-alone licences.

74 Korea–Jamaica, Agreement between the Republic of Korea and the Government of Jamaica for the Promotion and Protection of Investments, signed 10 June 2003, not yet in force.

75 ASEAN Agreement (2009), Canadian model FIPA.

76 E.g. COMESA Investment Agreement (2007), Art. 1.9.

77 India–Malaysia CECA (2005), Art. 10.2(d).

Protecting goodwill or reputation as investments under IIAs creates particular concerns, since including these interests in the definition of investment means that an investor may be able to claim damages in investor–state arbitration on the basis that an action of the host state has a negative impact on the value or reputation of its business.

- **Include intellectual property in the definition of investment, but use exclusions and reservations to protect particular areas of policy making:** A final approach, which is complementary to the others, is to include intellectual property in the definition of investment, but to use exceptions and reservations to ensure that host states are permitted to regulate intellectual property rights in accordance with domestic policy. The following are examples:
  - Even if intellectual property was a protected investment under an IIA, a state could preserve its right to issue compulsory licences of patented pharmaceuticals, a right specifically granted in the TRIPs Agreement, if the agreement provided that compulsory licences are not to be considered expropriations for the purposes of the IIA;
  - Derogations from national treatment and MFN are permitted by TRIPs, and these could also be permitted by express exceptions in an IIA; and
  - Another kind of exception that may relate to intellectual property interests, such as copyrights in music, literature and other art forms, is an exception from the obligations in the agreement for measures related to the promotion of culture.[78]

Issue 2(e): Should government securities and loans be excluded?

While most agreements are silent on this point,[79] the Canadian model FIPA specifically excludes government securities and loans of the host state.[80] By contrast, the Jamaica–Korea BIT specifically includes government-issued securities.[81] The likely rationale for excluding government securities and loans is a concern that if these investments were protected under IIA obligations, a government would be limited in its ability to restructure, reschedule or otherwise deal with its debt in times of financial crisis.[82] In addition such investments do not contribute directly to private sector economic activity.

On the other hand, excluding these obligations would presumably make it harder and more expensive for governments and state-owned enterprises to raise capital

78 A cultural exception is discussed below. See Section 5.12 (Reservations and exceptions).
79 The COMESA Investment Agreement (2007) excludes loans to a member state or state enterprise (Art. 1.9).
80 Canadian model FIPA, Art. 1. See also Colombia model agreement, Art. 2.1.
81 Korea–Jamaica BIT (2003), Art. 1.
82 It is also possible that the contract governing the debt provides for arbitration or enforcement in foreign courts which could be resorted to by investors, regardless of whether the debt was covered by an IIA or not.

from foreign investors. In some countries where state-owned enterprises do not operate with the benefit of a state guarantee of their obligations and must compete for capital against private enterprises, the blanket exclusion of debt issued by state-owned enterprises may put them at a disadvantage. Also, since the state is not responsible for their obligations, the inclusion of their obligations within the definition of investment would not impair a state's ability to manage its finances. One approach to addressing this problem would be to exclude the debt of state-owned enterprises that the state has guaranteed or for which the state has assumed direct or contingent liabilities.

As with intellectual property, it is possible that the specific concern regarding a host state's need to have flexibility to take action to respond to a financial crisis can be addressed using an exception. The use of a prudential exception for this purpose is discussed below.[83] Another alternative would be to include government securities and loans in the definition of investment but provide that no claim can be made in relation to these investments in investor–state dispute settlement.[84] This would not avoid the application of the obligations of the agreement but would prevent use of the investor–state process to claim compensation if a state breached an obligation in relation to this form of investment.

Issue 2(f): Should other exclusions be added?

Each state should consider what other exclusions might be incorporated in the definition of investment based on its domestic policy on investment, including categories of investment in which foreign participation is limited or prohibited. Examples of other exclusions include the following:

- **Property not being used for a business purpose:** Some IIAs exclude property that is being used for recreational, personal or other non-business purposes on the basis that the purpose of an IIA is to attract foreign capital that is to be used for productive business purposes.[85]
- **Agricultural land:** In many developing countries, foreign ownership of agricultural land is a sensitive issue. Often agriculture is a major area of economic activity and a successful agricultural sector is critical to national food security. Foreign investment can support increased agricultural production and enhanced food security. Nevertheless, concerns have been expressed that the protection of foreign investors' investments in agricultural land in IIAs can have negative consequences for food security because of the restrictions that are imposed on the ability of host states to regulate foreign investors who buy agricultural land, especially in weak states, and to comply with their international human rights

83 See Section 5.12 (Reservations and exceptions).

84 This was done in the United States–Peru Trade Promotion Agreement, signed 12 April 2006, in force 1 February 2009.

85 Japan–Singapore Economic Partnership Agreement, signed 13 January 2002, in force 30 November 2002, Art. 72(a); Canadian model FIPA, Art. 1 (regarding property that qualifies as an investment).

obligations.[86] States need to consider to what extent investment in agricultural land should be protected under their IIAs.

- **Assets of less than a certain value:**[87] Assets below a specified value threshold might be excluded from the definition of investment in an IIA in order to reduce the risk of investor–state claims by large numbers of small investors whose investments are not significant from an economic point of view. As discussed above, the small value of each such claim will discourage investors who hold them from bringing expensive investor–state claims, though this can be offset if the investors act collectively. In addition, some countries may want to protect small and medium-sized local businesses from competition. One way to do this is not to give foreigners carrying on small and medium-sized businesses incentives to invest in the form of the protection under an IIA. As discussed below, another approach is to limit the scope of the agreement by excluding investments in certain sectors characterised by small and medium-sized local businesses from the categories of investments under the IIA. For example, an IIA could exclude investments in hotels with fewer than 50 rooms.[88]
- **Changes in the form of the investment:** Most IIAs do not address what happens if an investment changes form. For these agreements, when an investment changes its form, the protection of the agreement continues to apply only to the extent that the new form meets the requirements of an investment under the IIA. A few IIAs expressly address whether a change in an investment should fall within the definition of investment. These agreements typically provide that a change in the form of the investment does not affect whether it is covered by the definition of investment.[89] Such an approach will be most attractive to investors because it ensures that their interests will be protected regardless of what happens to their investment. So, for example, if a shareholder in a corporation exchanged its shares for a debt claim against the corporation, the debt claim would be considered an investment, even if, on its own, the debt claim would not meet the requirements of the definition of investment in the IIA. For capital-importing states, however, it may be desirable to require that a changed investment must still fall within the definition of investment agreed to in the IIA to be protected, since that definition describes what they agreed to protect and an obligation to protect new forms of investment outside the definition is inherently unpredictable. In addition, protecting new forms of existing investments will not encourage new investment.

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86 F Smith (2012), 'Food Security, Foreign Direct Investment and Multilevel Governance in Weak States', presented at Third Biennial Global Conference of the Society of International Economic Law, National University of Singapore; C Häberli (2012), 'Foreign Direct Investment in Agriculture: Land Grab or Food Security Improvement', presented at Third Biennial Global Conference of the Society of International Economic Law, National University of Singapore; and UNCTAD (2012), *World Investment Report 2012*, United Nations, New York and Geneva, at 79.

87 UNCTAD (2011), *Scope and Definition*, op. cit., at 117.

88 See Section 4.5 (Scope of application).

89 E.g. UK IPPA, Art. 1.

Issue 2(g): Should the definition of investment limit eligible investments to investments made in accordance with host state law?

Many IIAs include in the definition of investment a requirement that the investment be made in accordance with the laws and regulations of the host state.[90] Such a requirement can also be included in a provision expressly setting out the scope of the IIA.[91] Locating this requirement in a scope provision highlights its importance. Though the precise meaning of such a requirement depends on the wording used, in general, such a provision, sometimes called an 'admission clause', is designed to limit the protection of the agreement to investments that have been admitted or approved by the host state in accordance with whatever domestic requirements exist.[92] Such a provision provides an incentive for foreign investors to comply with host state requirements in order to ensure that they benefit from the protections of the treaty. This type of provision is particularly important for countries that use their investment admission process as one way, perhaps the only way, of ensuring that investments contribute to sustainable development.

If an IIA contained a requirement that an investment be made in accordance with the laws and regulations of the host state in order to receive the protection of the treaty, the failure of an investor to obtain the necessary approval for a particular investment would mean that its investment would not be protected and an investor–state arbitration tribunal would not have jurisdiction to hear a claim by the investor. The same result would follow if the approval had been obtained but through misrepresentations or fraud or other corrupt actions on the part of the investor. There are some important limits on the ability of the state to rely on the absence of an investment approval or an investor's non-compliance with domestic law that have been imposed in investor–state arbitration awards:

- **A state's subsequent withdrawal of an approval properly given to an investment cannot be used to deny the protection of the IIA to the investment.** While an IIA provision could be drafted to permit a state to deny protection in this way, most do not give the host state such a broad discretion. If a host state did have discretion of this kind, it would be able to decide when the protections of the treaty would be available and the value of the protections of the treaty to the investor would be seriously diminished.[93]

90 E.g. UK IPPA, Art. 1; Indian BIPPA, Art. 1(b); COMESA Investment Agreement (2007), Art. 1(9); ASEAN Agreement (2009), Art. 4(a). Other model agreements do not (e.g. Canadian model FIPA; US model BIT).

91 See Section 4.5 (Scope of application).

92 Some tribunals have found that a requirement for investments to comply with local laws exists even in the absence of an express provision in an IIA. See the cases discussed in UNCTAD (2011), *Scope and Definition*, op. cit. at 38.

93 C McLachlan, L Shore and M Weiniger (2007), *International Investment Arbitration, Substantive Principles*, Oxford University Press, Oxford, at 196.

- **A country that accepts an investment in practice cannot later challenge the jurisdiction of an investor–state tribunal when the investor makes a claim on the basis that some formalities were not satisfied in connection with the approval of the investment.**[94] In this regard, the host state must act in good faith.
- **The requirement that an investment be made in accordance with national laws and regulations does not mean that the protection of the treaty extends only to investments *as defined in national law*.** While it would be possible to draft a provision that limited treaty protection in this way, IIAs with their own definitions of investment that include an additional requirement that an investment be made in accordance with national laws and regulations are not likely to be. 'Investment' will be as defined in the treaty. Otherwise, there would be no reason to have a specific definition of investment.[95] National definitions may be idiosyncratic and subject to change, so that reliance on them would undermine the predictability of an IIA for investors.
- **The requirement that an investment be made in accordance with national laws and regulations is unlikely to be interpreted to mean that the protection of the treaty only extends to investments that comply with all host state legal requirements on an ongoing basis throughout the life of the investment, though that will depend on the language used in the provision.** A requirement for continuous legality would make it very easy for a host state to avoid complying with the substantive investor protection obligations of the treaty by changing the laws to make an investor's investment non-compliant.[96]

Box 4.3 Summary of options for a definition of investment

This section lists the basic options that must be considered in drafting a definition of investment. Options 1 to 3 are presented in descending order beginning with the broadest definition that is most favourable to investors, followed by options for limiting the scope of the definition in various ways.

1. *Open definition of investment – 'Every kind of asset, including …'*
2. *Closed definition of investment – limited to the specific forms of assets identified*
3. *Possible limiting elements in a definition (whether open or closed)*
   a. An investment must have some or all of these attributes to be protected by the IIA:

(Continued)

94 *Desert Line Projects LLC v. Yemen*, ICSID Case no. ARB/05/17, Award, 6 February 2008.

95 A Joubin-Bret (2008), 'Admission and Establishment in the Context of Investment Protection', in A Reinisch (ed.), *Standards of Investment Protection*, Oxford University Press, Oxford, at 27.

96 In one case, a series of minor defects in filings by the investor were not found to render an investment one which was not made in accordance with the laws and regulations of the host state: *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, 19 April 2004, at 37–9.

(Continued)

i. have the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, and the assumption of risk;

ii. contribute to the development of the host state; and

iii. be made in accordance with host state law.

b. An investment covered by the IIA does not include some or all of these categories of investment:

i. portfolio investment;

ii. debt and other claims to money;

iii. intellectual property;

iv. government securities and debt;

v. property not used for a business purpose;

vi. agricultural land;

vii. assets below a specified value threshold; and

viii. other categories of investment in accordance with the domestic policy of the host state.

Discussion of options

1. *Open definition of investment: 'Every kind of asset, including…'*

This is the broadest form of definition and is found in most older BITs. It provides the most comprehensive protection for investors. Regardless of the form of their interest, it is likely to be covered by this definition. Correspondingly, there is some uncertainty regarding its scope that will make it difficult for a state to predict whether some kinds of interests qualify as investments.

Even with such a definition, however, in an ICSID arbitration a tribunal may require that specific requirements for an investment be present for the tribunal to have jurisdiction. These may include the following though ICSID tribunals have not been consistent in how they interpret 'investment':

i. A contribution in money or other assets;

ii. A certain duration;

iii. An element of risk;

iv. An operation made in order to develop an economic activity in the host state;

v. Assets invested in accordance with the laws of the host state;

vi. Assets invested *bona fide*; and

vii. A contribution to development.

2. *Closed definition of investment: limited to the specific forms of assets identified*

This form of definition may still be very broad and so protect most kinds of interests. Nevertheless, because it is limited to defined categories of assets, it is more predictable for host states, permitting them to target the application of the agreement at the categories of investment that they want to attract, facilitating compliance with their obligations and management of their risk of investor–state claims.

3. *Possible limiting elements in a definition (whether open or closed)*

A definition of investment may require some or all of these attributes for the investment to be covered by the IIA:

i. Have the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, and the assumption of risk;

ii. Contribute to the development of the host state; and

iii. Be made in accordance with host state law.

As noted with respect to a closed definition of investment, imposing limits on what is an investment for the purposes of an IIA permits states to: (i) target the obligations of the agreement at categories of investment that it seeks to attract; (ii) facilitate compliance with their obligations; and (iii) limit the categories of investments that can be the subject of an investor–state claim.

Requirements that an investment have the characteristics of an investment appear in many IIAs, including the US model treaty, and will be required in any ICSID investor–state arbitration. Such a requirement helps to ensure that protected investments make an economic contribution to the host state. At the same time, these requirements introduce some uncertainty regarding when an investment qualifies for protection under the treaty.

A specific requirement that an investment contribute to development is not commonly found in IIAs, although it is sometimes imposed by ICSID tribunals in arbitrations under the ICSID Convention regardless of what definition of investment is included in the applicable IIA. Such a requirement goes some way to ensuring that protected investments are limited to those that benefit the host state. At the same time, this requirement introduces significant uncertainty into the definition of investment. A definition that excludes portfolio investment is another way to target an IIA definition of investment at significant investments making a contribution to the economy of the host state.

Uncertainty regarding the scope of the definition makes the application of the agreement harder to predict. Such uncertainty may deter some investors and make it more difficult for states to comply with their obligations. Notwithstanding their uncertainty, these kinds of requirements for an investment to be eligible for

protection can work to the advantage of host states. In some cases, there will be scope for a host state to argue that an investor–state arbitration tribunal does not have jurisdiction to hear an investor's claim because the investor has not made an eligible investment. Such jurisdictional challenges may be used to stop an investor bringing a claim that is an abuse of the investor–state process.[97] For example, if an investor set up a controlled subsidiary in a state that is a party to an IIA and then transferred an existing investment that it had made in the other party state to the IIA (the *host state*) to the subsidiary for the sole purpose of bringing an investor–state claim, the host state may be able to challenge the jurisdiction of the investor–state tribunal on the basis that the investment did not make a contribution to its development after the transfer to the subsidiary in the other party state.

The requirement that investments be made in accordance with host state law is included in many IIAs. Such a requirement allows the host state to control through its domestic policies what foreign investments obtain the benefit of the treaty. Such a power will be especially important for a state that has limited capacity to regulate an investor once it has entered the country. It also provides an incentive for foreign investors to comply with host state rules in order to ensure that they benefit from the protections of the treaty.

An investment covered by the IIA may exclude some or all of these categories of investment:

i. Portfolio investment;
ii. Debt and other claims to money;
iii. Intellectual property;
iv. Government securities and debt;
v. Property not used for a business purpose;
vi. Agricultural land;
vii. Assets below a specified value threshold; and
viii. Others in accordance with the domestic policy of the host state.

In general, the desirability of particular exclusions will depend on the policies of the host state. In some cases, policy sensitivities related to specific kinds of investments, such as intellectual property, can be addressed in other ways in an IIA, such as through exceptions and reservations, rather than by excluding those kinds of investment from the definition of investment.

It is also possible to limit the practical impact of obligations in relation to particular categories of investment by excluding them from the scope of the dispute settlement procedures in the treaty.

97 *Phoenix Action v. Czech Republic*, op. cit.

Discussion of sample provision

The sample provision provides an example of what a definition of investment could include. No single definition will be optimal for all states, in all circumstances. Host states must make individual choices regarding how broadly to define an investment considering their domestic policy and their own priorities for attracting investment in particular forms by including such forms within the definition of investment, recognising that as the definition of investment expands so does the scope of host state obligations and the corresponding risk of investor–state claims.

Closed definition

In the interests of clarity, predictability and precision, the sample definition of investment in the Guide provides a closed definition with several exclusions. This approach follows an emerging trend in IIA drafting and provides the best approach for host countries to manage the scope of their liability.

The sample provision in the Guide provides an example of a relatively narrow definition of investment compared with many existing IIAs. Most investments within the definition are interests in enterprises. It also imposes a general requirement that to be an investment, the asset must have the typical characteristics of an investment, including making a contribution to development. Even though this last characteristic is somewhat uncertain in scope, it has been required by a number of ICSID tribunals and so may be imposed in an arbitration under the ICSID Convention even if it is not in the treaty. In addition, ICISD cases considering the requirement provide some guidance regarding its scope of application.

Exclusions

Consistent with the Canadian and US model agreements and in the interests of clarity, certain specific exclusions have been incorporated in the definition:

- **Volatile short-term debt, defined in the Guide as debt with a maturity of less than three years**: The intention of this provision is to exclude loan transactions from the definition of investment that are volatile and less likely to make a direct contribution to new economic activity. While three years is admittedly an arbitrary benchmark, it is predictable and has been used in some agreements.
- **Debt securities issued by a state or a state enterprise**: These securities were excluded to ensure that states have flexibility to deal with their debt obligations in the event of a financial crisis. Excluding these securities may make it marginally more difficult or expensive for states and state enterprises to raise capital in international markets.
- **Claims to money arising out of commercial contracts for the sale of goods or services between national enterprises in different party states and property not used for a commercial purpose**: These kinds of interests are not investments as commonly understood and are unlikely to make a direct contribution to new economic activity. They are excluded in some IIAs.

Consistent with widespread IIA practice, the sample provision does not contain an exclusion for portfolio investment. Examples of such an exclusion are provided above and the sample indicates where such an exclusion could be included. As discussed, there is no easy way to define such an exclusion that is not either very vague or arbitrary. Nevertheless, some countries may want to incorporate such an exclusion in an IIA. There is no exclusion for investments below a specific value threshold because such a provision is uncommon and inevitably somewhat arbitrary.

Intellectual property included but exceptions added to protect host state policy space

Like the IIA models used by most countries, the Guide's definition of investment includes intellectual property used for business purposes, which is broad enough to include intellectual property rights in recognition of the general importance of intellectual property rights protection to investors. However, intellectual property rights protection is limited to categories of rights consistent with TRIPs that are recognised in the host state's law. As noted, reservations and exceptions may be included to protect a host country's ability to avoid specific adverse effects associated with the exercise of such rights. In particular, the Guide provides an example of a provision that excludes the granting of compulsory licences in accordance with a state's intellectual property obligations from what constitutes an expropriation requiring compensation.[98] In addition, the Guide describes how reservations may be used to protect host states' policy-making flexibility in relation to intellectual property[99] and how broad exceptions can protect interests that may be affected by intellectual property rights.[100]

Investment in accordance with law

Finally, to ensure that host states can require that investors make their investments in accordance with local requirements related to development and other policies expressed in domestic legislation, it is important to require that investments be made in accordance with the host state's law in order to be eligible for protection under the treaty. Because of the fundamental importance of this requirement, it is included in the Guide sample provision defining the scope of the treaty's application, rather than in the definition of investment.[101] It could, however, be incorporated in the definition of investment.

4.3.2 Definition of investor

However investment is defined, IIAs apply only to investments by *investors* of one party state in the territory of the other party state. For this purpose, investors may be either natural or legal persons. The only issue regarding who is an investor eligible

98 See Section 5.6 (Limitations on expropriation and nationalisation).
99 See Section 5.12 (Reservations and exceptions).
100 See Section 5.12 (Reservations and exceptions).
101 See Section 4.5 (Scope of application).

for protection is what link an investor must have with a party state in order to be considered an investor of that state.

In most cases, investors are likely to want the broadest possible definition of investor so that, however their business is structured and no matter how weak their connection to a state, they will benefit from the protection of the IIAs that the state has signed. Some capital-exporting states may also want a broad definition that is easy to satisfy. For example, a state that is pursuing a strategy of becoming an international business centre by encouraging foreign investors to set up in its jurisdiction as a platform to make investments in other countries will want to have a very open definition of investor that creates minimal hurdles for foreign businesses to obtain the protections in the IIAs that that the state has signed. This is the policy of Mauritius, for example. Other capital-exporting states may want to ensure that only investors that have made a substantial contribution to their economy can benefit from the protections in the treaties they negotiate with other states.

Capital-importing host states may have different preferences in this regard. A state that is targeting a limited class of investor in a particular sector may want to ensure that investors protected under the treaty are strongly connected to the treaty partner they are negotiating with in order to manage their exposure to investor–state claims. Such states will be concerned about the risk that investors will organise their corporate structure for the sole purpose of taking advantage of the treaty, sometimes known as *treaty shopping*. A very open and easily satisfied definition of investor in a treaty means that investors from many states will be able to take advantage of the treaty protections, multiplying the risk of investor–state claims. For some states, treaty shopping may not be an issue. If their goal is simply to maximise the investment they attract, they may not mind if an investor from a non-party state is able to organise itself to take advantage of the treaty so long as they receive the investment.

Natural persons

Most IIAs require natural persons to be nationals of a state in order to qualify as investors of that state.[102] Typically, nationality is determined conclusively by the domestic law of the state whose nationality is in issue. The Canadian model and some others provide that permanent residents of a state also qualify as investors of that state.[103] This may be because, as a high immigration country, many investors from Canada are permanent residents who are not yet citizens, with the result that limiting protection to people who are citizens would narrow the scope of protection unduly.[104]

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102 US model BIT, Art. 1; UK model IPPA, Art. 1(c); COMESA Investment Agreement (2007), Art. 1.4.

103 Canadian model FIPA, Art. 1, Norwegian Draft model APPI, Art. 1. The ASEAN Agreement (2009) also permits investors to be permanent residents or citizens, as does Australia–Argentina, Agreement between the Government of Australia and the Government of the Argentine Republic on the Promotion and Protection of Investments, signed 23 August 1995, in force 11 January 1997 (only for Australians).

104 UNCTAD (2011), *Scope and Definition*, op. cit., at 74.

Actual residency in a state is seldom required, although parties to an IIA may consider it desirable to require some other link to a party state in addition to nationality as a condition of acquiring treaty protection, such as carrying on some economic activity in the state.[105]

Natural persons connected to more than one state

Where both permanent residents and citizens of a state are defined as investors of a state, it is possible that a single person could be a citizen of one party state to an IIA and a permanent resident of another. In this situation, a person who is a permanent resident (or a citizen) of a party state could try to seek the benefit of treaty protection for actions of that country that are contrary to the treaty, relying on their status as a citizen (or permanent resident) in the other party state. This occurred in one case under NAFTA.[106] The problem can be avoided by defining investors as including only nationals.

This solution does not work if a person has the nationality of both parties to an IIA. Few treaties address this problem, which in some cases can have practical implications. For example, developing country nationals often emigrate to developed countries and obtain the nationality of that country. If they return to their home country as investors they may seek to qualify for preferential programmes set up for the exclusive benefit of nationals. They may also seek protections under an IIA between their country of birth and the developed country whose nationality they have acquired as an investor of the developed country.

The doctrine of dominant or effective nationality, which has been developed in public international law to determine which nationality of a person should be given effect in dual nationality cases, has been rejected in a number of investor–state arbitration cases as a way to resolve this problem.[107] Consequently, if a state wants to address this problem it must do it expressly in the definition in the IIA. One kind of provision that assigns nationality in cases of dual nationality appears in the US–Argentina BIT, which provides 'that a person who is a dual citizen shall be deemed to be exclusively a citizen of the State of his or her dominant and effective citizenship'.[108] Another approach is adopted in the Canada–Lebanon Foreign Investment Protection Agreement, which provides simply that a person who is a Canadian and a Lebanese national has the nationality of the state in which they are present.[109] In the absence of these kinds of provisions, a dual national might be able to claim either nationality and use their

105 Ibid. at 123.

106 *Marvin Roy Feldman Karpa v. United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award 16 December 2002, affirmed *United Mexican States* v. *Karpa* (2005), 74 *Ontario Reports* (3d) 180 (Court of Appeal).

107 *Micula v. Romania*, ICSID Case No. ARB/05/20, Decision on Jurisdiction and Admissibility, 24 September 2008.

108 US–Uruguay BIT (2005), Art. 1.

109 Canada–Lebanon, Agreement between the Government of Canada and the Government of the Lebanese Republic for the Promotion and Protection of Investments, signed 11 April 1997, in force 19 June 1999, Art. 1.

nationality of one state as the basis for their claim against another state of which they are a national. With respect to IIAs that provide for investor–state arbitration under the ICSID Convention, a few additional complications arise, as discussed in Box 4.4.

The sample provision in the Guide defines investors to include only nationals and has a test for effective nationality with a view to avoiding the problems discussed above.

Box 4.4 Nationality and the ICSID Convention

Under Article 25 of the ICSID Convention, disputes may be arbitrated under the rules of the Convention only if the dispute is between a contracting state and a national of another contracting state. 'National of another contracting state' means

a. Any **natural person** who had the nationality of a contracting state other than the party state to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered … *but does not include any person who on either date also had the nationality of the contracting state party to the dispute*; and

b. Any **juridical person** which had the nationality of a contracting state other than the party state to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any *juridical person* which had the *nationality of the contracting state party to the dispute* on that date and which, *because of foreign control, the parties have agreed should be treated as a national of another contracting state* for the purposes of this Convention. (Emphasis added.)

Natural persons: The effect of this provision is that, under the ICSID Convention, a natural person can initiate an arbitration only if the person:

- Has the nationality of a contacting state in accordance with the laws of that state; and
- Does not have the nationality of the state complained against (the *host state*).

Consequently, dual nationals who have the nationality of the host state cannot use the ICSID arbitration process. This is true regardless of whether the nationality of the host state would be the person's effective nationality under international law.[110] An IIA provision that assigns nationality to one state on some basis in cases of dual nationality may not be effective to overcome this limitation. Even if an IIA would permit a claim because an investor's effective

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110 *Champion Trading v. Egypt*, ICSID Case No. ARB/02/9, Decision on Jurisdiction, 21 October 2003.

(Continued)

nationality is not that of the host state, ICSID arbitration may not be available. An investor in this situation would have to choose some other arbitral process if permitted under the IIA.

The ICSID treaty also identifies the dates when these nationality requirements apply: the date on which the parties consented to submit their dispute to conciliation or arbitration, and, in the case of claim by a natural person, the date on which the request was registered.

Legal persons: For corporations and other legal persons, typically the dual nationality problem does not arise. Nationality is defined in the IIA. As discussed below, usually the nationality of a legal person is attributed to the state in which the legal person is organised. However, Article 25 permits the parties to agree that a legal person that had the nationality of the host state on the relevant date but is under 'foreign control' can be treated as having the nationality of another party state to the ICSID Convention to permit the legal person to bring the claim. This provision addresses the common situation in which a foreign investor is carrying on business in the host state through a corporation incorporated in the host state that it controls (a *subsidiary*). In the absence of this rule, if the test for nationality under the IIA is the jurisdiction under which the corporation is organised, the subsidiary would have the same nationality as the host state and be precluded from ever making a claim in ICSID arbitration. The foreign investor that controls the subsidiary could, however, make a claim on its own behalf for injuries that it has suffered.

Only some IIAs permit claims against host states by host state-incorporated subsidiaries. In those that do, often the consent of the state to permit claims by foreign-controlled local subsidiaries is set out in the dispute settlement provisions of the IIA.[111] The requirement for 'foreign control' has been held by ICSID arbitration tribunals to be an objective standard that must be satisfied irrespective of any agreement between the parties regarding how nationality should be determined.[112] To ensure that the requirements for ICSID dispute resolution are met, IIAs should permit claims by subsidiaries only when they are foreign controlled.

Note: The requirements of the ICSID Convention apply only to arbitrations under the Convention. Arbitrations under other rules are not affected. Eligibility of an investor to make a claim under other arbitral rules will be determined exclusively by the applicable IIA and those rules.

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111 E.g. Canadian model FIPA, Art. 23. Consent may also be given in a contract with the host state in relation to a particular investment.

112 *Vacuum Salt v. Ghana*, ICSID Case No. ARB/92/01, Award, 16 February 1994. See P Muchlinski (2007), *Multinational Enterprises and the Law*, Oxford University Press, Oxford, at 728–9.

Legal persons

Nationality based on a legal person being incorporated or organised in a state

With respect to legal persons (also called 'juridical persons'), most IIAs define investor of a state as meaning corporations and other forms of business organisation incorporated or organised under the laws of that state.[113] Often both for-profit and not-for-profit entities, as well as state-owned enterprises, are expressly included. The Canadian model FIPA and the US model BIT follow this approach.[114] The rationale for including not-for-profit entities is that they may make investments in commercial operations to produce revenues that they can apply to their charitable purposes. In addition, not-for-profit entities may make valuable investments, such as in schools or medical clinics that will be of interest to a host state.[115] Including not-for-profit entities in the definition of investor may encourage them to invest.

Another category of investor often expressly included in the definition of investor is party states and their entities, such as sovereign wealth funds, an increasingly important source of global capital. Concerns that sovereign wealth funds and other state-owned enterprises (SOEs) operate in a manner that is not transparent and may be responsive to their home state's policies, rather than host state interests or the commercial considerations that would determine the behaviour of private investors, have caused some states to question the desirability of investments by such investors.[116] Some states have adopted special investment screening requirements to address these concerns. In some cases, SOE investment will be permitted only if certain standards for transparency and independence from their home state are satisfied.[117]

In addition, some IIAs provide that an unincorporated branch of a business enterprise located in a state and carrying out business activities there is considered an investor of that state. This approach is followed in the Canadian and US model agreements.[118]

The US and Canadian model agreements employ a broad definition that includes all these types of investors. In the US and Canadian model agreements an 'investor of a party' means 'a Party or state enterprise thereof, or a national or an enterprise of a Party.' In turn, 'enterprise' is defined as follows:

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113 UK model IPPA, Art. 1(d). The same is true for most BITS entered into by Caribbean and Pacific countries (Malik, op. cit., at 11, 44–5).

114 Some others follow this approach too, e.g. SADC Investment Protocol (2006), definition of company, Art. 1.

116 UNCTAD (2011), *Scope and Definition*, op. cit., at 80–1.

116 L Skovgaard Poulsen (forthcoming), 'Investment Treaties and the Globalisation of State Capitalism: Opportunities and Constraints for Host States', in R Echandi and P Sauvé (eds), *Prospects in International Investment Law and Policy,* Cambridge University Press, Cambridge.

117 See the discussion of Canadian policy in this regard in J VanDuzer (2010), 'Mixed Signals: What Recent Developments Tell Us about Foreign Investment Policy in Canada,' 10 *Asper Review of International Business and Trade Law*, 247 at 251–4.

118 Canadian model FIPA, Art. 1; US model BIT, Art. 1. The approach in the India–Singapore CECA (2005) is similar.

> Any entity constituted or organized under applicable law, whether or not for profit, and whether privately or governmentally owned or controlled, including a corporation, trust, partnership, sole proprietorship, joint venture, association, or similar organization, and a branch of an enterprise.

Most other definitions are not as comprehensive in that they do not expressly extend their coverage to not-for-profit entities or party states and SOEs specifically, though they still rely on incorporation or organisation as the test for nationality. For example the Indian model agreement simply defines Indian investors as 'corporations, firms, associations incorporated, constituted or established in any part of India'.[119] Not-for-profit enterprises may fall within this kind of definition. Indian SOEs incorporated in India will fall within this definition.

The simple incorporation or organisation test for the nationality of a legal person has two main advantages:

- It is simple for investors to qualify; and
- It is easy for both investors and host states to determine if an investor is eligible for protection under the IIA.

Potentially, however, the protection is very broad. Even though the investor must have made an investment, in a variety of situations described in Box 4.5, being able to claim the benefits of the treaty for an investment in one party state by simply incorporating a controlled subsidiary corporation in the other party state for the purpose of making the investment means that some protected investors may not be providing new capital to the host state. Furthermore, the state in which the subsidiary was incorporated may be concerned that an investor is benefiting from a treaty that it has negotiated without having any real economic activity in the state.[120]

Box 4.5 Treaty-shopping opportunities created by a simple incorporation or organisation test for the nationality of a legal person in an IIA

If an IIA provides that the nationality of a legal person is determined exclusively by the state in which it is incorporated or organised, investors have opportunities to structure their affairs to take advantage of the treaty. This means that a state may end up extending the promised protections in an IIA to a broad range of investors that have little economic connection with the other party state. It also means that, in some cases, investors will be able to secure protection when the

(Continued)

119 Indian model BIPPA, Art. 1. The ASEAN Agreement (2009) is similar.

120 In *Alps Finance and Trade AG v. Slovak Republic*, Award (redacted version), Investment Ad Hoc Arbitration, 5 March 2011, the tribunal described the concerns of states with respect to the connection that an investor should have to benefit from the protection of a BIT in the following terms: 'the object and purpose of the BIT, as reflected in its preamble, is to intensify the economic cooperation between states for the mutual benefit of both states and, to attract foreign investments with the aim to foster their economic prosperity' (at para. 236).

(Continued)

investment does not result in new capital being brought into the host state. The following are examples.

- *Example 1: Investor of third party state incorporates a subsidiary in a party state to an IIA to obtain treaty protection in another party state to the IIA*

  A natural person, who is a citizen of State A, or a corporation incorporated in State A (INVESTOR A) seeks to invest in State B but there is no IIA between State A and State B. There is an IIA between State B and State C that provides that an investor has the nationality of State C and, as a result, is entitled to the protection of the IIA if it is incorporated or organised in State C.

  INVESTOR A incorporates a subsidiary corporation in State C that it controls and provides it with capital to make the desired investment in State B.

  State B is obliged to give the protection of the IIA to the investment.

  In this situation, new capital did result from the investment, but it may have been capital that would have been invested in State A anyway. To this extent, the treaty protections are being extended to an investor, but may not have been necessary to induce the investment.[121]

- *Example 2: Investor in a party state to an IIA state incorporates a subsidiary in the other party state to the IIA to obtain treaty protection in their own state*

  A natural person, who is a citizen of State B, or a corporation incorporated in State B (INVESTOR B) seeks to invest in State B. There is an IIA between State B and State C that provides that an investor has the nationality of State C and, as a result, is entitled to the protection of the IIA if it is incorporated or organised in State C.

  INVESTOR B incorporates a subsidiary corporation in State C that it controls and provides it with capital to make the desired investment in State B.

(Continued)

121 Investors with the nationality of a party state to an IIA have standing only if they make an investment in another party state to the IIA. Most definitions of investor permit the investment to be made 'directly or indirectly'. This means that in Example I, where there is an IIA between State B and State C, an investor with the nationality of State C (INVESTOR C) is entitled to the protection of the IIA in relation to an investment in State B, even if the investment is directly owned by a corporation incorporated in State A, which, in turn, is controlled by INVESTOR C. See *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB (AF)/00/3, Award, 30 April 2004; and *SOABI v. Senegal*, ICSID Case ARB/82/1, Decision on Jurisdiction, 1 August 1984.

(Continued)

State B is probably obliged to give the protection of the IIA to the investment.[122]

Since the source of the capital is INVESTOR B in State B and the investment is in State B, the net effect of this transaction is that no new capital has been invested in State B (though existing capital has been put to a different use) and INVESTOR B has the protections of the IIA. This may be a concern to State B only to the extent that the protections available to the INVESTOR B under the IIA and/or the mechanisms for their enforcement are better than the protections available to INVESTOR B under the domestic law of State B.

Additional links to a party state to an IIA as a condition of obtaining nationality

As a consequence of the risk of treaty shopping illustrated by the examples in Box 4.5, definitions in IIAs sometimes impose additional requirements for corporations and other legal persons to be considered to be sufficiently connected to a party state in order to be an investor of the Party under the treaty. Either some actual business activity being carried on in the state or the ultimate owners of the investment possessing the nationality of the state, or both, may be required. In some treaties, for example, legal persons are required to have their head office or headquarters in a state or to have substantial business operations in the state to be considered a national of that state, though different formulations of these requirements are used.

- In the UK model agreement, an investor must be 'engaged in business operations' in the territory of the treaty party in which it is organised to have the nationality of that party.[123]
- The COMESA Investment Agreement requires 'substantial business activity in the Member State in which it is constituted or organised' to be an investor of the state.[124]
- In the India–Singapore CECA, a corporation with 'negligible or nil business operations or with no real and continuous business activities carried out in

122 *Tokios Tokelés v. Ukraine*, op. cit. In this case, the investor did not structure the investment with the intention of taking advantage of the treaty protection. Nevertheless, the majority award suggests that this would be possible. This approach has been followed in subsequent cases such as *ADC v. Hungary*, ICSID Case No. ARB/03/16, Award, 2 October 2006, para. 360, but not others, e.g. *TSA Spectrum de Argentina S. A. v. Argentine Republic*, ICSID Case No. ARB/05/5, Award, 19 December 2008 at paras. 114–62. In that case the tribunal determined that a Dutch company was owned by Argentine nationals. The claim against Argentina was not allowed to proceed but on the basis that the investor was not under 'foreign control' as required by Article 25(2)(b) of the ICSID Convention.

123 UK model IPPA, Art. 1. The Canada–Jordan Free Trade Agreement, signed 28 June 2009, in force 1 October 2012, follows the same approach except that it refers to 'business activities' (Art. 1(k)).

124 COMESA Investment Agreement (2007), Art. 1(4).

the territory of the party' is excluded from the definition of investor of that party.[125]

- In the China–Jamaica BIT, a corporation has Chinese nationality only if it is 'domiciled' in China as well as incorporated there.[126] Domicile in this context probably means that the principal place of business of the corporation is in China.
- In the South Korea–Jamaica BIT, a corporation has the nationality of a state in which it is incorporated only if it has its 'seat' in the state.[127] A corporation's seat is located where it is effectively managed.[128]

One difficulty with all of these expressions is applying them in practice. Perhaps the most difficult to apply is the requirement to have business activities or operations, even if modified by the adjective 'substantial'. Substantial business activity has been found to exist where an investor has premises from which it conducts the investment business and a small but permanent staff.[129] Nevertheless, significant uncertainty remains regarding just what is required to meet this test.[130] 'Seat' has a well-established meaning: the principal place of business and location of effective management. The presence of a corporation's seat, however, may still represent a relatively slight connection to a jurisdiction. In one arbitration award, a corporation was found to have its seat in a country where its only connections were that it had one resident director and had an audit of its financial statements done in the country.[131] A few treaties require that an investor should both have its seat in a jurisdiction and carry out activities there in order to have the nationality of the jurisdiction.[132]

The German–Antigua and Barbuda BIT requires both business presence and control. A juridical person is considered to have the nationality of Antigua and Barbuda only

125 India–Singapore CECA (2005), Art. 6.1(6). The same agreement provides in a somewhat duplicative way that a party may deny benefits of the treaty to an investor that 'has no substantial business operations in the territory of the other Party' (Art. 6.9).

126 China–Jamaica, Agreement between the Government of the People's Republic of China and the Government of Jamaica, signed 26 October 1994, in force 15 November 1996.

127 Korea–Jamaica BIT (2003), Art. 1; Colombian model agreement, Art. 1.1.b. This provision also requires that the investor have substantial business activities in the same state.

128 UNCTAD (2011), *Scope and Definition*, op. cit., at 83.

129 *AMTO v. Ukraine*, Arbitration Institute of the Stockholm Chamber of Commerce, Arbitration No. 080/2005, Award, 26 March 2008, cited in UNCTAD (2011) *Scope and Definition*, ibid., at 96–7.

130 The COMESA Investment Agreement (2007) provides that determining whether substantial business activity exists requires an 'overall examination, on a case-by-case basis, of all the circumstances including, among other things: (a) the amount of investment brought into the country; (b) the number of jobs created; (c) the effect on the local community; and (d) the length of time the business has been in operation' (Art. 1(4)).

131 *Yaung Chi Oo Trading PTE LTD. v. Government of the Union of Myanmar*, ASEAN I.D. Case ARB/01/1, 42 *International Legal Materials* 540 (31 March 2003).

132 E.g. Switzerland–Iran, Agreement Between the Swiss Confederation and the Islamic Republic of Iran on the Promotion and Reciprocal Protection of Investments, signed 8 March 1998, in force 1 October 2001, Art. 1(1)(b), (c); Colombian model agreement Art. 1.1(b) (includes also entities controlled by nationals of a state).

if it has 'its main operation in Antigua & Barbuda and … [the] operation is controlled directly or indirectly by citizens of Antigua & Barbuda'.[133] Few IIAs contain such a control requirement.[134] Given the complex corporate structures used by multinational enterprises and non-equity control mechanisms, determining who has ultimate control of operations will be a daunting challenge in some cases.

Another approach – denial of benefits

Another approach to ensure that the incorporation or organisation test for nationality is not abused by 'treaty shopping' is to add a provision that permits a party state to deny the benefits of the treaty to investors unless certain criteria are met in addition to incorporation or organisation in a state. Usually denial of benefits by a state is permitted where an investor does not have substantial business operations in the state and the investor is ultimately controlled by other investors who are not nationals or legal persons of that state.[135]

In principle, a denial of benefits provision may operate automatically, in which case it is effectively part of the definition of investor, or it may require some positive action by the denying state. With an automatic denial of benefits, the protections of the treaty are not available if some specific requirement, such as carrying out substantial activities in the jurisdiction, is not met. Under the Canadian model, however, a positive action is required. A state must give prior notification of its intention to deny benefits.

The practical effectiveness of such a discretionary denial of benefits clause may be limited. In one case involving a similar treaty provision, a state sought to deny benefits after an investor had initiated a claim in investor–state arbitration. The tribunal, however, ruled that it was too late.[136] To take advantage of the denial of benefits provision, the tribunal held that the state had to act prior to a claim being made. This would seem to mean that to take advantage of a denial of benefits provision like this, a state would have to monitor foreign investments constantly to determine if the criteria for denying benefits are met and then decide whether it wants to deny benefits in a particular case prior to being aware of any claim. If this were what was required, however, the provision would be practically useless. Even under the approach adopted in this case, however, it might be possible to rely on such a provision where an investor

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133 Germany–Antigua and Barbuda BIT (1998).

134 Malik, op. cit., at 14, 45, regarding Caribbean and Pacific BITS.

135 Canadian model FIPA, Art. 18; US model BIT, Art. 17(2). This approach is also followed in the European Energy Charter Treaty, signed 17 December 1994, in force 16 July 1998 (Art. 17(1)) and the Indian model BIPPA (Art. 12). In the US and Canadian models, the protection of the treaty may also be denied where the ultimate owners of the investment are from a country with respect to which the denying state has some kind of measure that would be violated if the benefits of the agreement were accorded to the investment or the investors. A trade embargo would be an example of such a measure. No notice is required by the denying party in these circumstances.

136 *Plama Consortium Ltd. v. Republic of Bulgaria*, ICSID No. ARB/03/24, Decision on Jurisdiction, 8 February 2005.

has indicated that it may make a claim but before it has formally initiated arbitration proceedings.[137] This would be much more useful for states.

A more recent case interpreting a different denial of benefits clause gave the host state much more flexibility to deny benefits. It found that there was no time limit specified in the treaty for the exercise of the respondent state's right to deny benefits and permitted the denial after the investor's claim had been filed, noting that the denial was made within the time limit for filing a jurisdictional challenge under the applicable arbitral rules.[138]

It would be highly advantageous for a host state to be able to deny benefits after a claim had been filed because it could investigate whether the criteria for denial of benefits were met in relation to that particular investor and take a decision based on the specific facts of the case. At the same time, a denial of benefits clause that could be exercised after a claim had been filed would undermine the benefits of the treaty for some investors. In light of the conflicting views expressed by arbitral tribunals, in order to ensure that a state can deny benefits after a claim is made, the treaty should expressly permit the state to do so.

Box 4.6 Summary of options for a definition of investor in an IIA

1. *Natural persons:* A natural person is an investor of a party state if that person is
   a. A national of a party state as determined by that state; or
   b. A national *or* permanent resident of a party state as determined by that state.
2. *Legal persons:* A legal person is an investor of a party state if that person is incorporated or organised under the law of the party state. Any or all of the following criteria may be added. The investor
   a. Has (substantial) business activities in that state;
   b. Has its seat (or effective management) in that state; and/or
   c. Is owned or controlled by nationals (legal or natural persons) of that state.
3. *A state can deny benefits of the treaty to a legal person where it does not meet one of criteria a, b or c in option 2*

137 UNCTAD (2011), *Scope and Definition*, op. cit., at 98–9.

138 *Pac Rim Cayman LLC v. Republic of El Salvador*, ICSID Case No. ARB/09/12, Decision on the Respondent's Jurisdictional Objections, 1 June 2012, regarding Art. 10.12.2 of the US–Central American–Dominican Republic Free Trade Agreement, signed 4 August 2004, in force (for all countries) 1 January 2009 (at paras 483–5). The arbitration was under the ICSID Rules.

Discussion of options for a definition of investor

Investors may be either natural or legal persons.

1. *Natural persons*

Under most IIAs, a natural person is an investor of a party state if that person is either

a. A national of the party state as determined by that state; or

b. A national *or* a permanent resident of the party state as determined by that state.

The definition may go on to provide that where a natural person has dual nationality, their nationality belongs to the state with which they have the most effective connection or, alternatively, the state that they are in. Dual nationals that have the nationality of the host state, however, may be precluded from making a claim in ICSID arbitration. This may be true even if the IIA includes a provision that defines a person as having a single nationality for the purpose of the treaty, and, on the basis of the application of the provision, the person would not have the nationality of the host state. This problem arises only in arbitrations under the ICSID rules.

While high immigration states, such as Canada, may want to include permanent residents as well as nationals, this is likely to be a small and less important category of investor for other states that they may not want to include. It creates the possibility that a person may be a national of one party state to a treaty and a permanent resident of another party state. A state may avoid this problem by limiting the definition of investor to nationals. This is the most common approach in IIAs.

2. *Legal persons*

Many IIAs provide that a legal person is an investor of a party state if that person is incorporated or organised under the law of the party state. Some IIAs impose one or all of the following additional criteria. The investor:

a. Has (substantial) business activities in that state;

b. Has its seat (or effective management) in that state; and/or

c. Is owned or controlled by nationals (legal or natural persons) of that state.

In choosing how to define the nationality of legal persons for the purposes of their eligibility for protection under an IIA, each state will have to determine to what extent it is worried about treaty shopping and what additional criteria it wants to adopt. While some requirement for the seat of the investor and/or some business activity are common, a requirement for ultimate ownership or control to exist in a state is less common. An ultimate ownership or control requirement may be more difficult to apply in practice, because of the challenge of locating ownership within complex corporate structures.

3. *A state can deny benefits of the treaty to a legal person where it does not meet any one of criteria a, b or c in option 2*

As an alternative to including the limitations discussed in option 2 in the definition of investor, an IIA may include a provision that allows a state to deny the benefits

of the treaty where an investor does not satisfy any or all of criteria a, b or c in relation to the other party state to the treaty. In principle, this would permit a state to deny the benefit of the protections of the treaty when it determined that an investor was merely incorporated in a party state and should not be given the protection of the treaty for some reason. However, if the treaty requires a state to take a positive step to deny benefits under the IIA, this step might have to be taken *before* the investor commences an investor–state arbitration. If the treaty is interpreted to require action before the claim is filed, the denial of benefits provision loses much of its practical utility. Specific wording in the treaty could be used to ensure that a state may deny benefits after an investor makes a claim and the state has an opportunity to consider whether benefits should be denied to that investor.

Discussion of sample provision

Natural persons

In the interests of clarity and administrative simplicity, the sample provision requires that for a natural person to be an investor of a party state they must be a national of that state, and that if they are a national of more than one state, they have the nationality of the state with which they have the closest connection. As an alternative, states may want to simply exclude their own nationals from the protection of an IIA, even if they also have the nationality of the other party state. Such an approach would avoid any conflict with the ICSID Convention, which would be useful if the IIA allowed for the possibility of ICSID dispute settlement.

Legal persons

The sample provision requires that, to be an investor of a party state, the investor must:

- Be an enterprise incorporated or organised under the law of the state;
- Have its seat in the state; and
- Carry on substantial business activities in that state.

Incorporation or organisation in a state is almost universally used as one of the criteria for a legal person to be a national of that state. The sample provision does not include an unincorporated branch located in the territory of a party. Without local incorporation or organisation, the party state may find it more difficult to regulate an investor. Enterprise is the expression used to define legal persons. Enterprise is defined broadly to mean 'any entity constituted or organised under applicable law, whether or not for profit, whether privately-owned or governmentally-owned, including any corporation, trust, partnership, sole proprietorship, joint venture or other association' so as to avoid formalistic limitations on what category of business organisation qualifies for protection. Not-for-profit and government-owned investors are included. States should consider whether SOEs should be included based, in part, on their capacity to regulate such investors effectively.

The requirement for the investor's seat is intended to provide a relatively certain test that would help to avoid treaty shopping. The seat requirement is, however, more restrictive and less flexible than the simple incorporation or organisation test, which is the only test in most IIAs. The substantial business presence in the state requirement was added to provide additional assurance that an investor has a real economic link to a state before it is eligible for protection under the treaty. Both seat and substantial business activity, however, remain somewhat uncertain. Both could be further defined by more detailed specific requirements, such as those listed in the COMESA Investment Agreement.

An ownership or control test has not been included because of the complexity of defining control in a way that will be effective and not unduly restrictive for investors in their choices of business structure. It is rarely used in IIA practice. Such a requirement could be used to ensure that investors are closely connected with a treaty party in order to benefit from the protections of the treaty. An ownership or control requirement is provided for in the sample denial of benefits provision.

Denial of benefits provision

A sample denial of benefits provision is included in the sample provisions. A party state can deny the benefits of the agreement to an investor that is incorporated or organised under the laws of the other party state, but is not owned or controlled by investors of the other party state. This is the most common form of denial of benefits provision and is found in the Canadian model among others. The sample provisions have been drafted to make clear that the state's right to deny benefits can be exercised after the investor's claim has been filed. Where the investor has initiated an investor–state claim, the denial can be made at any time prior to the expiry of the time within which jurisdictional challenges may be filed by the host state under the arbitral rules applicable to the claim. In order to deny benefits, a party state must give notice to the other party state.

4.3.3 Sample provision: definitions

Definitions[139]

For the purpose of this Agreement:

Commission means the commission of ministerial-level representatives of the Parties established under this agreement [see Guide Section 9.2 (Commission)].

Cultural industries means persons engaged in any of the following activities:

i. The publication, distribution or sale of books, magazines, periodicals or newspapers in print or machine readable form but not including the sole activity of printing or typesetting any of the foregoing;

ii. The production, distribution, sale or exhibition of film or video recordings;

iii. The production, distribution, sale or exhibition of audio or video music recordings;

139 Defined terms used in other sample provisions are also set out here.

iv. The publication, distribution, sale or exhibition of music in print or machine readable form; or

v. Radio communications in which the transmissions are intended for direct reception by the general public, and all radio, television or cable broadcasting undertakings and all satellite programming and broadcast network services [see Guide Section 5.12 (Reservations and exceptions)].

Days means calendar days, including weekends and holidays.

Enterprise means any entity constituted or organised under applicable law, whether or not for profit, whether privately owned or government owned, including any corporation, trust, partnership, sole proprietorship, joint venture or other association.

ICSID means the International Centre for Settlement of Investment Disputes.

ICSID Convention means the *Convention on the Settlement of Investment Disputes between States and Nationals of other States*, done at Washington, 18 March 1965 [see Guide Section 7.1 (Investor–state dispute settlement)].

Intellectual property rights, in relation to the obligations of a Party means copyright and related rights, trademark rights, rights in geographical indications, rights in industrial designs, patent rights, rights in layout designs of integrated circuits, rights in relation to protection of undisclosed information, and plant breeders' rights to the extent protected under the laws of the Party.

Investment means:

i. An enterprise;

ii. An equity security of an enterprise;

iii. A debt security of an enterprise:

   a. where the enterprise is an affiliate of the investor, or

   b. where the original maturity of the debt security is at least three years, but does not include a debt security, regardless of original maturity, of a state enterprise;

iv. A loan to an enterprise

   a. where the enterprise is an affiliate of the investor, or

   b. where the original maturity of the loan is at least three years,

   but does not include a loan, regardless of original maturity, to a state enterprise; and

   for greater certainty, a loan to, or debt security issued by, a Party or a state enterprise thereof is not an investment;

v. An interest in an enterprise that entitles the owner to share in income or profits of the enterprise;

vi. An interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraphs (iii) or (iv);

vii. Real estate, intellectual property or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and

viii. Interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under:

   a. contracts involving the presence of an investor's property in the territory of the Party, including turnkey and construction contracts, and concessions, or

   b. contracts where remuneration depends substantially on the production, revenues or profits of an enterprise;

provided that an investment must have the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, and the assumption of risk and must make a contribution to development;

but investment does not mean:

ix. Claims to money that arise solely from:

   a. commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of the other Party, or

   b. the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (iv); and

   c. any other claims to money, that do not involve the kinds of interests set out in subparagraphs (i) through (viii);

x. [Other exclusions could be added here, including an exception for portfolio investment as defined in the IIA.]

Investor of a Party means

i. An enterprise constituted or organised under the law of a Party that has its seat and carries on substantial business activities in that Party; and

ii. A natural person who is a citizen of a Party, provided that that a natural person who is a dual citizen of both Parties shall be deemed to be exclusively a citizen of the Party of his or her dominant and effective citizenship;

that has made an investment.

Measure includes any law, regulation, procedure, requirement or practice.

New York Convention means the *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, done at New York, 10 June 1958 [see Guide Section 7.1 (Investor–state dispute settlement)].

Person means a natural person or an enterprise.

State enterprise of a Party means an enterprise that is owned or controlled through ownership interests by a Party.

Sub-national government means:

in respect of [Party] …; and

in respect of [Party] … [see Section 5.3 (National treatment)].

Territory means

in respect of [Party] …; and

in respect of [Party] …[140]

Tribunal means an arbitration tribunal established under this agreement [see Guide Section 7.1 (Investor–state dispute settlement)].

UNCITRAL Arbitration Rules means the arbitration rules of the United Nations Commission on International Trade Law, approved by the United Nations General Assembly on 15 December 1976, as amended [see Guide Section 7.1 (Investor–state dispute settlement)].

WTO Agreement means the Agreement Establishing the World Trade Organization done at Marrakesh, 15 April 1994.

4.3.4 Sample provision: denial of benefits

Denial of Benefits

1. A Party may deny the benefits of this Agreement to an investor of the other Party that is an enterprise of such Party and to investments of such investors if investors of such non-Party do not own or control the enterprise.
2. A Party shall give notice to the other Party of its intention to deny benefits to an investor of the other Party under Section 1.
3. Where an investor has made a claim against a Party under this agreement, the Party may deny benefits to the investor in accordance with this article at any time prior to the expiry of the time within which jurisdictional challenges may be filed by the Party under the arbitral rules applicable to such claim.

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140 Countries should consider how to define the scope of their territory by reference to: (a) their land territory, air space, internal waters and territorial sea; (b) those areas, including the exclusive economic zone and the seabed and subsoil, over which the country may exercise, in accordance with international law, sovereign rights or jurisdiction for the purpose of exploration and exploitation of the natural resources; and (c) artificial islands, installations and structures in the exclusive economic zone or on the continental shelf over which the country has jurisdiction as a coastal state.

4.4 Statement of objectives

Cross reference

Section 4.2.1 The role of preambles in IIAs 42

In addition to the preamble, an explicit statement of objectives is an important part of the interpretive context for a treaty as noted above.[141] A separate section setting out objectives is a useful way to give priority to particular objectives referred to in the preamble, though most agreements currently in place make limited use of such a provision.

4.4.1 IIA practice

Most national models, such as those used by Canada, the USA, the UK and India, and the Norwegian draft model, do not include a statement of objectives. In those that do, investment promotion is typically identified as an objective of the agreement. The COMESA Investment Agreement, for example, identifies investment liberalisation and promotion in its general objectives provision.[142]

Some IIAs express a wider range of objectives than investment promotion. In the part of the agreement setting out the main protections for investors, for example, the COMESA Investment Agreement goes on to state that the objective of the agreement is also to 'provide COMESA investors with certain rights in the conduct of their business within an overall balance of rights and obligations between investors and Member States.'[143] This language suggests that investor protection is not the sole overriding purpose of the agreement. Investment liberalisation and promotion is also the main objective identified in the ASEAN Agreement, but in a separate section on guiding principles, 'flexibilities to Member States depending on their level of development and sectoral responsibilities' is listed.[144]

Box 4.7 Summary of options for an objectives provision

1. *No objectives provision*
2. *Objectives provision that refers only to investment promotion and protection*
3. *Objectives provision that refers to objectives in addition to investment promotion and protection*

141 See Section 4.2.1 (The role of preambles in IIAs).

142 COMESA Investment Agreement (2007), Art. 2. Because it is a regional agreement, the objectives provision also refers to strengthening and increasing the competitiveness of COMESA's economic activities and jointly promoting COMESA as an attractive investment area.

143 COMESA Investment Agreement (2007), Art. 11.

144 ASEAN Agreement (2009), Arts. 1 & 2. The India–Singapore CECA (2005) has a more extensive statement of general objectives for the entire agreement in Art. 1.2, which includes 'to establish a transparent, predictable and facilitative investment regime'.

4.4.2 Discussion of options

1. *No objectives provision*

This is the most common practice in existing IIAs. Because an objectives provision is an important part of the interpretive context, not including one means that interpreters of the IIA have limited direction regarding how its obligations should be interpreted. The objectives of the treaty will be inferred from the provisions that it contains. Without an objectives provision an interpreter of the treaty has more discretion to determine its objectives and to interpret the agreement accordingly. An IIA that primarily contains investment protection provisions is likely to be found to be intended to protect investors to the exclusion of other goals. Some interpretive direction can be given through a preamble in the absence of an objectives provision.

2. *Objectives provision that refers only to investment promotion and protection*

By identifying only two objectives, the promotion and protection of investment, this kind of objectives provision prioritises these objectives for any interpreter of the agreement, including an investor–state tribunal. An interpreter is likely to feel compelled to disregard other policy considerations. Interpretive direction in a preamble can complement or qualify the direction in an objectives provision. An interpreter is likely to give more weight to an objectives provision. To encourage consistent and predictable interpretation, the objectives provision and the preamble should be consistent.

3. *Objectives provision that refers to objectives in addition to investment promotion and protection*

In this form of objectives provision, the parties have an opportunity to identify and prioritise their intentions in entering into an IIA to include a broad range of considerations, including contributing to sustainable development. The interpretive direction in an objectives provision can be complemented or qualified by a preamble. As noted, the objectives provision and the preamble should be consistent.

4.4.3 Discussion of sample provision

In the Guide's sample provision, the objective of attracting investment for the purposes of sustainable development is the sole objective identified. Certainly, another objective of the agreement, and one that may be of paramount importance to capital-exporting states, is the protection of investments; many of the IIA provisions discussed in the Guide provide such protection. Capital-exporting states may insist that this purpose be recognised expressly in the objectives provision. It might be argued in response that protection of investments is implicit in their promotion. The benefit of indicating the single objective of promoting foreign investment to support sustainable development is that it makes clear the paramount importance of investment promotion and the achievement of sustainable development through legitimate regulatory activities of the host state. The investment protection provisions in an IIA with this kind of objective provision should be understood as a means of achieving this objective.

Such an approach should discourage interpreters of the treaty from engaging in a weighing of the relative importance or balancing of investment protection against the promotion of investment and sustainable investment,[145] though some tribunals may view protection as a necessary and incidental aspect of an IIA that promotes investment.

4.4.4 Sample provision: objective

Objective

The objective of this Agreement is to promote foreign investment that supports and facilitates sustainable development in accordance with legitimate regulation by the host state, including the protection of internationally and domestically recognised human rights, labour rights and the rights of indigenous peoples and the environment.

4.5 Scope of application

Cross references

Section 4.2.1	The role of preambles in IIAs	42
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Provisions defining the scope of an IIA represent an opportunity for the parties to expressly indicate what is and what is not covered by the agreement. Few IIAs contain separate provisions expressly defining their scope of application.[146] Many IIAs simply define their scope through the definitions of investors and investments that are entitled to protection under the treaty. Nevertheless, there are several additional issues that can be dealt with in scope provisions.

4.5.1 IIA practice

Relatively few IIAs contain scope provisions that are identified as such, though many agreements contain provisions that expressly address their scope of application in some way. The scope issues typically addressed include the following:

- Defining when obligations begin to apply;
- Limits on the application of the agreement

145 The IISD model treaty identifies sustainable development as its sole objective (Art. 1).

146 India's model agreement limits its application to 'investments … accepted as such in accordance with its laws and regulations' (Indian model BIPPA, Art. 2).

- to investments made in accordance with host state law;
- in relation to certain policy areas, sectors or measures;
- in relation to measures of sub-national actors; and

- Limits on what may be the subject of dispute settlement.

When do obligations begin to apply?

Some treaties expressly apply only to investments made *after* the treaty comes into force, though most apply to protect investments regardless of whether they had been made at the time the IIA became effective or after.[147] A few treaties that protect investments in place when the treaty came into effect provide that the agreement do not apply to disputes related to measures of the host state that were in place prior to that date, even if they continue to be in place afterwards.[148]

One of the main objectives of capital-exporting states in negotiating IIAs is often to protect existing investments in host states. In principle, however, extending protection to investments already in place will not induce new capital inflows. Consequently, for host countries, the benefit of protecting pre-existing investments is likely to be small.[149] There may, nevertheless, be a marginal benefit for host states to the extent that such protection encourages foreign investors to stay who, in the absence of such protection, might have left. Similarly, such an approach may create an incentive for investors with investments that pre-date the treaty to retain investment returns in the host country and to invest further.[150]

In Sections 6.6–6.11 (obligations of investors), the Guide describes provisions that impose obligations on investors that are intended to ensure that investment contributes to sustainable development. If such obligations on investors are included in an IIA, it is necessary to indicate when they begin to apply. From a host state point of view, such obligations would be most effective if they commenced at the time that the treaty came into force and applied to investments in place at that time as well as new investments.

Scope limited to investments made in accordance with host state law

As discussed in relation to the definition of investment above,[151] it is useful to limit the application of an IIA to investments made in accordance with the laws and

147 E.g. Indian model BIPPA, Art. 2; IISD model treaty, Art. 4; Canadian model FIPA, Art.1; US model BIT, Art. 1; India–Singapore CECA (2005), Art. 6.2(1); COMESA Investment Agreement (2007), Art. 12.2 (though only investments registered under the agreement are protected). The same is true for all Caribbean and Pacific BITS (Malik, op. cit., at 14, 46).

148 E.g. Colombian model agreement Art. II. Many treaties also provide that parties may deny the benefits of the treaty to certain investors in certain circumstances (e.g. Canadian model FIPA, Art. 18). See Section 4.3 (Definitions) 'investor'.

149 The Asian-African Legal Consultative Committee, op. cit., described the imposition of IIA obligations in relation to pre-existing investments as 'controversial'.

150 The duration of treaties is discussed below. See Section 9.3 (Termination of IIAs).

151 See Section 4.3 (Definitions).

regulations of the host state. While this can be done in the definition of investment, it can also be done in the scope of the agreement clause. The latter approach gives more profile to the limitation.

Some policy areas, sectors or measures excluded

Some IIAs contain scope provisions that exclude certain policy areas, sectors or measures from the application of the agreement, where both parties agree that these areas should not be covered, perhaps because of their sensitivity or their connection to state policy or security. Some agreements exclude policy areas such as government procurement, subsidies to local businesses and social services, such as health and education.[152] The Colombian model agreement excludes a policy area, taxes, and certain specific measures relating to the financial sector.[153] Alternatively, these kinds of exclusions may be set out as exceptions or reservations to the agreement.[154] In some cases, exceptions in an IIA have been interpreted narrowly as being contrary to the main goals of the agreement. One possible advantage of excluding a sector or activity in a scope provision, as compared with an exception or reservation, is that a scope limitation might not be interpreted narrowly in this way. Where states wish to exclude different policy areas, sectors and measures from the agreement, each may list them in a national schedule of reservations. Both reservations and exceptions are discussed below.[155] It is also possible to limit the scope of an IIA's application by agreeing to its application only to sectors that each state lists.[156]

Application to measures of sub-national actors

As a matter of general international law, a state is responsible for actions of all entities that can be attributed to the state. These include actions of courts, administrative tribunals and regulators, as well as sub-national levels of government. If any actor whose actions are attributable to the state performs actions that are contrary to an international treaty obligation, the state is internationally responsible in the absence of an applicable exception or reservation in the treaty.[157]

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152 For example, the ASEAN–Australia–New Zealand Free Trade Agreement, signed 27 February 2009, in force 3 January 2010, excludes government procurement, subsidies and services supplied in the exercise of governmental authority (Art. 1).

153 Colombian model agreement, Art. II.4 and II.5. As discussed below under Section 5.2 (Right of establishment), it is also possible to provide that the IIA applies only to listed sectors. This approach is adopted in the ASEAN Agreement (2009), Art. 3.3.

154 See Section 5.12 (Reservations and exceptions), Section 5.3 (National treatment) and Section 5.4 (Most favoured nation).

155 See Section 5.12 (Reservations and exceptions).

156 This is called positive listing and is described in Section 5.2 (Right of establishment).

157 *Vienna Convention on the Law of Treaties*, Art. 27; UN (2001), Report of the International Law Commission, Fifty-third session (23 April–1 June and 2 July–10 August 2001), UN Doc A/56/10, United Nations.

If an IIA provides for investor–state arbitration, actions of all state actors can be the subject of claims. Some agreements create express exclusions for actions by municipalities and other sub-national actors.[158] These kinds of limitations are discussed below.[159]

Limitations on dispute settlement and umbrella clauses

A final possible limitation relates not to the scope of application of the agreement, but rather to the scope of access to dispute settlement procedures that are available under it. It may be desirable to provide that some of the obligations in the treaty cannot be the subject of an investor–state claim by an investor. While investors will want to ensure that they can claim if the host state has breached a specific investor protection obligation, there may be obligations in the agreement for which an individual investor is not a direct beneficiary and which should not be the subject of investor–state claims. An obligation for states to consult regarding technical assistance, for example, is an obligation that implicates only the party states and a failure of either state to perform would not be an appropriate basis for an investor–state claim.[160] These kinds of limitations are discussed below.[161]

In addition, some obligations may be sufficiently sensitive that states will not want them to be the subject of state-to-state dispute settlement. Where state obligations regarding areas such as environmental protection, human rights, labour rights and the rights of indigenous peoples, of the kind that are discussed in the sample provisions below, are being undertaken, states may decide to exclude them. These kinds of limitations are discussed below.[162]

Some treaties contain an *umbrella clause*, which provides that obligations that a state owes to investors but that are not specifically set out in the treaty are considered to be treaty obligations and can be the subject of the dispute settlement procedures under the treaty. As discussed below,[163] there are few benefits to host states associated with such clauses and they expand the scope of host state obligations in unpredictable ways.

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158 The Canadian model FIPA excludes the application of some provisions to all existing measures of sub-national governments (Art. 9). The US model BIT excludes the application of some provisions from all existing measures of listed central and regional government entities as well as of local governments.

159 See Section 5.12 (Reservations and exceptions) and Section 5.3 (National treatment) and Section 5.4 (Most favoured nation).

160 See Section 8.2 (Technical assistance).

161 See Section 7.1 (Investor–state dispute settlement).

162 See Section 7.2 (State-to-state dispute settlement).

163 See Section 7.1 (Investor–state dispute settlement).

Box 4.8 Summary of options for a scope provision

1. *No scope provision*
2. *Include a scope provision*

   A scope provision can be used to do any of the following:

   a. Define when the agreement begins to apply and whether pre-existing investments are protected;

   b. Limit the application of the agreement to investments made in accordance with the laws and regulations of the host state;

   c. Limit the application of the agreement by listing policy areas, specific sectors and measures to which the agreement does not apply;

   d. Exclude the application of the agreement to sub-national governments; and

   e. Limit access to dispute settlement.

4.5.2 Discussion of options

1. *No scope provision*

This is the most common practice in existing IIAs. The scope of the agreement will be determined by the definitions of investor and investment and the language used in individual provisions. In the interests of clarity, it is helpful to have a scope provision, especially if the parties wish to have particular limitations on the agreement's application.

2. *Include scope provision*

If a scope provision is included, the parties need to decide how it will address the following issues.

   a. Define when the agreement begins to apply and whether pre-existing investments are protected

This kind of limitation provides clarity to investors and states regarding the date the IIA begins to apply and the extent to which pre-existing investments are protected. The protection of investments in place at the time that the treaty comes into force is a common objective of capital-exporting states, but it will have a limited effect on inducing new investment. If the scope of the IIA is limited to investments made after the date the treaty comes into force, there will be differential treatment of investments that pre-date the treaty. It is also possible that there will be some uncertainty regarding the status of reinvestment by investors whose initial investment pre-dated the IIA.

A separate issue is how to deal with host state measures that pre-date an IIA coming into force. In the interests of assisting host states to manage their risk of investor–state

claims, all claims relating to measures of the state prior to the agreement coming into force could be excluded. Such a provision should address whether measures that were put in place prior to the treaty coming into force but which continue to affect investors after that date can be the subject of an investor complaint.

Distinct considerations arise in relation to the commencement of obligations on investors. As discussed below in the Guide, one way to help ensure that IIAs contribute to sustainable development is to impose obligations on investors to comply with host state laws and to meet specific standards in relation to human rights, labour rights, indigenous peoples' rights, not engaging in bribery and corruption, and undertaking sustainability assessments of their investments. If obligations on investors are included in an IIA, it is useful to indicate when they begin to apply. From a host state point of view, investor obligations would be most effective in contributing to sustainable development if they commenced at the time that the treaty came into force and applied to investments in place at that time as well as new investments.

b. Limit the application of the agreement to investments made in accordance with the laws and regulations of the host state

This kind of limitation ensures that only investments that were properly approved under the state's domestic rules when they came into the host state territory qualify for protection. It is a very common and useful limitation that ensures that only investments that a state has determined are desirable under its domestic policy benefit from the obligations of the IIA. Such a limitation can also be included in the definition of investment.[164]

As discussed below, most IIAs do not give protection to investors prior to the admission of the investment.[165] For a treaty that provides for pre-establishment rights for investors, it may be necessary to specify a different earlier commencement date for the investor obligations. To be effective, obligations that are to apply prior to establishment must extend to investors seeking to make or who are in the process of making investments.

c. Limit the application of the agreement by listing specific policy areas, sectors and measures to which the agreement does not apply

This kind of limitation may be of interest to states that have policy areas, sectors or measures that are sensitive and in which foreign investment is not permitted or with respect to which a state does not want to undertake the commitments in the IIA. Scope limitations of this kind can be used to preserve flexibility to develop and implement national policies. Policy areas, sectors and measures can also be excluded in reservations and exceptions. Scope limitations and exceptions apply to both parties. Reservations are unique to each party. Alternatively, states can agree that the IIA will apply only to sectors that they list.

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164 In IIAs that provide for pre-establishment rights a host state will be subject to limits on its ability to prevent investments from investors of the other party state. See Section 5.2 (Right of establishment).

165 See Section 5.2 (Right of establishment).

d. Exclude the application of the agreement to sub-national governments

Most capital-exporting states and their investors will want IIA obligations to extend to all government actors that could take actions that would affect them. Some states may not want to assume obligations at the sub-federal level, perhaps because local governments will either not be aware of IIA obligations or be unwilling to comply with them.

e. Limit access to dispute settlement

This kind of limitation does not restrict the obligations of party states, but only the extent to which they may be the subject of investor–state or state-to-state dispute settlement. States may decide that IIA obligations that are not intended to provide direct protection to investors should be excluded from the obligations that may be the subject of an investor–state claim. Some obligations may be so sensitive that a state may not want to be obliged to defend its compliance with them in state-to-state dispute settlement.

4.5.3 Discussion of sample provision

Applies to all investments by investors of another party, whenever made: In the interests of clarity and predictability, the sample provision in the Guide provides that the obligations of the treaty apply only to measures taken by the host state after the treaty becomes effective in relation to all investments by investors of party states, regardless of when the investment was made. In light of the fundamental importance of existing investor protection to capital exporting countries and the possible marginal benefits to host countries, the Guide provision extends protection to existing investments, as do most IIAs.

Claims arising out of events before the treaty comes into force excluded: In order to assist states to manage the risk of investor–state claims, it would be desirable to exclude the application of the agreement to disputes arising prior to the agreement coming into force. This could be done in the sample provisions on dispute settlement. It is done in the sample scope provision.[166] By referring to measures adopted after the treaty comes into force, the sample provision excludes all measures in place at the time that the IIA comes into force, including those that continue in force after that date. Investor–state claims can be made only in relation to measures adopted after the agreement comes into force. With the adoption of such an approach, it becomes unnecessary to use a reservation to list pre-existing measures that a state wants to exclude from the application of the treaty.

Investor obligations: The sample provision makes clear that any investor obligations included in an agreement also apply upon the agreement coming into force in relation to investments made before or after that date. This would be necessary only in an IIA that included obligations on investors. When particular IIA obligations on investors commence in relation to a particular investment is discussed below in the section on rights of establishment.[167]

166 See Section 7.1 (Investor–state dispute settlement).

167 See Section 5.2 (Right of establishment).

Sub-national governments not excluded: The sample provision does not address its application to sub-national government entities. Instead, the sample provision on reservations contemplates the possibility of excluding measures of sub-national governments.[168] If the party states wanted to exclude all measures of sub-national governments, it could be done in the scope provision.

Listed policy areas and sectors excluded: The sample provision includes a subsection that permits parties to list policy areas and sectors to which the agreement does not apply. The Guide also discusses how states may limit the scope of the agreement by listing sectors and specific measures that are excluded from the application of all or certain portions of the agreement using reservations and exceptions.[169] Subsidies and grants, government purchases of goods and services, and taxation measures, for example, are excluded in the sample provisions.

Scope limited to investments made in accordance with the laws and regulations of the host state: The sample provision limits the application of the treaty to investments made in accordance with the laws and regulations of the host state. Such a provision is sometimes called an 'admission clause'. The importance of this limitation was discussed above in relation to the definition of investment.[170]

Limits on investor–state and state-to-state dispute settlement: Possible limits are discussed below in relation to each form of dispute settlement.[171]

4.5.4 Sample provision: scope of application

Scope of Application

1. This agreement applies to measures of a Party adopted after this agreement comes into force relating to investors of the other Party and their investments, whether the investment is made before or after this agreement comes into force, provided that the investment has been made in accordance with the laws and regulations of the Party.

2. With respect to obligations on investors in [Guide sample provision Sections 6.6–6.11 (obligations of investors)], this Agreement applies to investors of a Party and their investments whether the investment is made before or after this agreement comes into force.

3. This agreement shall not apply to … [list policy areas or sectors]

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168 See Section 5.12 (Reservations and exceptions).

169 See Section 5.12 (Reservations and exceptions). Other limitations on the scope of particular provisions are discussed in the section discussing the provision.

170 See Section 4.3 (Definitions).

171 See Section 7.1 (Investor–state dispute settlement) and Section 7.2 (State-to-state dispute settlement).