Chapter 5

Substantive Obligations of Host States Regarding Investor Protection

5.1 Introduction

The dominant feature of existing IIAs is that they create substantive obligations that host states must observe in relation to investors from the other party state. In this chapter, the Guide discusses the main categories of the core obligations found in existing IIAs.

Recent investor–state arbitration decisions have raised some serious concerns regarding the potential scope of some of the generally worded substantive obligations found in many IIAs.[1] If domestic laws, regulations or policies violate these substantive standards and cause losses to an investor, the settlement of the dispute through investor–state arbitration can result in an award requiring the host state to compensate investors. A number of cases recently decided by investor–state tribunals have required developing countries to compensate the investor when domestic laws and regulations have had a negative effect on investments based on surprisingly broad interpretations of IIA obligations.[2] Compensation may be required even where a measure was intended to achieve important domestic policy goals, including policies related to development, financial stability and public health. Some critics argue that IIAs can negatively affect the capacity of host states to comply with their international human rights obligations,[3] especially in relation to economic, social

1 B Hoekman and R Newfarmer (2005), 'Preferential Trade Agreements, Investment Disciplines and Investment Flows', 39 *Journal of World Trade* 949 at 966.

2 See, for instance, *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, 21 May 2005; *Compañía de aguas del aconquija s.a. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, 21 November 2000; *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Award, 28 September 2007; *Enron Corporation & Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award 22 May 2007.

3 As of 20 November 2008, the following Commonwealth members had ratified or acceded to the *International Covenant on Civil and Political Rights* (adopted 16 December 1966 in force 23 March 1976), 999 *United Nations Treaty Series* 171: Australia, Bangladesh, Barbados, Belize, Botswana, Cameroon, Canada, Cyprus, Dominica, The Gambia, Ghana, Grenada, Guyana, India, Jamaica, Kenya, Lesotho, Malawi, Maldives, Malta, Mauritius, Mozambique, Namibia, New Zealand, Nigeria, Papua New Guinea, St Vincent and the Grenadines, Samoa, Seychelles, Sierra Leone, South Africa, Sri Lanka, Swaziland, Trinidad and Tobago, Uganda, United Kingdom, United Republic of Tanzania, and Zambia. As of 20 November 2008, the above member countries (excluding Belize, Botswana, Mozambique, Samoa and South Africa), but with the addition of the Solomon Islands, had ratified or acceded to the *International Covenant on Economic, Social and Cultural Rights* (adopted 16 December 1966, in force 3 January 1976) 993 *United Nations Treaty Series* 3.

and cultural rights.[4] It is also argued that IIA obligations may restrict the ability of host states to make regulations to protect the environment.[5]

Limitations that IIAs impose on the ability of governments to enact new laws and regulations that apply to foreign investors are of particular concern from the point of view of sustainable development where the host state is considering creating new legal mechanisms to protect the environment, or protect or promote human rights, labour rights or the rights of indigenous peoples. Box 5.1 sets out an example of this.

Box 5.1 ***Vivendi v. Argentina***

An example of the difficulties IIAs can pose for the power of states to enact future laws and regulations is the case of *Vivendi v. Argentina*.[6] The case dealt with a decision of the government of the Argentine province of Tucumán to change its policy regarding a water utility. The utility had been privatised under the government of President Carlos Menem, but local politicians became dissatisfied with the service provided by the French investor who had been granted the concession, because of both a perceived decline in water quality and an increase in the price of water for the community. The provincial government took various steps to replace the foreign owner, Vivendi, which then complained that Argentina (via its province, Tucumán) had violated its obligations under the BIT between France and Argentina. The tribunal found in favour of the foreign investor. The case illustrates a scenario in which a government was required to pay costly compensation under an IIA to a foreign investor when it sought to change a policy with significant human rights implications (in this case, the right to water), based on legitimate governmental concerns.

4 States have both immediate and continuing obligations under international human rights treaties to respect, protect and fulfil the rights in relation to each individual subject to their jurisdiction – see for example, Article 2 of both the ICCPR and the ICESCR. The obligation to *protect* human rights requires states to take legislative, administrative and other measures in order to control and regulate the activities of non-state actors that may violate human rights, and in cases where a violation occurs, to investigate and prosecute such actors. See, for example, *Vélásquez Rodriguez v. Honduras*, (1989) 28 *International Legal Materials* 294; *Herra Rubio v. Colombia* (161/1983), (1988) *HRC Report*, GAOR, 43rd Sess., Supp. 40, 190 [11]; *Ergi v. Turkey* (App. 23818/94) (1998) 32 EHRR 388; *Timurtas v. Turkey* (App. no. 23531/94) (2000) ECHR 13 June 2000; and *A v. UK* (App. no. 25599/94) (1999) 27 EHRR 611.

5 See, for example, K Miles (2011), 'Sustainable Development, National Treatment and Like Circumstances in Investment Law', in M-C Cordonier Segger, A Newcombe and M Gehring (eds), *Sustainable Development in World Investment Law*, Kluwer Law International, The Hague, at 266.

6 *Vivendi v. Argentina*, op. cit.

When awards are made, the required compensation can be quite costly.[7] Even where a state successfully defends an investor's claim, the costs involved can be substantial.[8] As a result, in order to comply with their obligations and manage the risk of claims being made, states must carefully determine the amount of freedom they wish to maintain to make changes to laws, regulations and policies that might affect investment, and ensure that such freedom is protected in the IIAs they sign.

Some countries have adopted different forms of clarifying language in their IIA models that limit the scope of application of core IIA obligations. Some of these approaches are incorporated in the Guide's sample provisions to help preserve host state flexibility.[9] The increasingly common use of exceptions and regulations to exclude the application of investor protection obligations from sectors, measures or policy areas is also discussed.[10] Given their technical nature, and the fact that they have been adopted by major developed countries in the IIA models that they use, these kinds of further specification of the party state's obligations may be acceptable to prospective treaty partners and are unlikely to have an impact on investment flows.

This section of the Guide discusses these core provisions, beginning with a fundamentally important issue that arises in some forms of IIA currently in use: whether the IIA grants foreign investors from party states a *right* to invest in other party states.

5.2 Right of establishment

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7 In the case of *CMS Gas*, op. cit., the award was US$133 million plus interest; in the case of *Vivendi*, op. cit., US$105 million plus interest; in the case of *Sempra*, op. cit., approximately US$128 million plus interest; and in the case of *Enron*, op. cit., US$106.2 million plus interest.

8 The costs of investor–state arbitration are discussed in more detail in Section 7.1 (Investor–state dispute settlement).

9 See Section 5.3 (National treatment), Section 5.4 (Most favoured nation), Section 5.5 (Fair and equitable treatment and the minimum standard of treatment), Section 5.6 (Limitations on expropriation and nationalisation), Section 5.7 (Compensation for losses), Section 5.8 (Free transfer of funds), and Section 5.10 (Transparency).

10 See Section 5.12 (Reservations and exceptions).

According to UNCTAD, '[t]he right to control admission and establishment remains the single most important instrument for the regulation of FDI'.[11] Control over the admission of foreign investors is likely to be especially important for countries that have a limited capacity to regulate foreigners operating within their borders. For example, foreign investors may engage in anti-competitive conduct that would be hard to address in the absence of effectively enforced competition laws, which few developing countries have.

Some IIAs contain provisions that have the effect of granting a right for foreign investors from one treaty party to enter the domestic market of the other party and carry on business. Such a right is sometimes called a 'right of establishment'. These rights could have implications for the protection of human rights and the environment, and the attainment of other development and regulatory objectives to the extent that they operate to preclude host states from screening prospective foreign investors and investments and thereby limit their ability to ensure that a particular foreign investment contributes to the protection of human rights or the environment and/or facilitates the progressive realisation of such objectives.[12] Granting a right of establishment could deprive the host state of an important tool that cannot easily be replaced through domestic regulation. At the same time, a right of establishment enhances the certainty and predictability of access to the host state market and may encourage foreign investment inflows.

5.2.1 IIA practice

As noted, most IIAs, such as the Indian model BIPPA, limit their application to investments that have been lawfully admitted according to the host state's domestic investment regime. Admission of new investments is permitted, but only subject to compliance with whatever requirements are imposed under the national law of the host state.[13] There is no right for foreign investors to enter the host state.

An increasing number of treaties, however, include limited rights that operate for the benefit of foreign investors before they have made an investment. The purpose of these rights is to commit party states to allow investors to enter the host country market and operate there.

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11 UNCTAD (2003), *World Investment Report 2003: FDI Policies for Development: National and International Perspectives*, United Nations, New York and Geneva, at 102.

12 India has argued in the WTO that developing states need to retain this capacity to screen investments. See WTO, *Communication from India*, Working Group on the Relationship between Trade and Investment (2 October 2002), Doc. No. WT/WGTI/150 at para. 12.

13 E.g. Indian model BIPPA, Art. 2. See also India–Bangladesh BIT, Art. 2 and ASEAN–Australia–New Zealand FTA, Art. 2(a). In the UK model IPPA, states are obliged to admit investors from the other party, but only 'in accordance with its laws and regulations' (Art. 2.10). It is not obvious that this is different in effect from the Indian model BIPPA. None of the Pacific BITs, and only a few Caribbean BITs, include a right of establishment (M Malik (2009), *Report on Bilateral Investment Treaties*, Commonwealth Secretariat, London, at 14, 47). The India–Singapore CECA provides for a right of establishment in listed sectors only (Art. 6.3(1)). While the national treatment obligation in the ASEAN Agreement includes 'establishment, acquisition, expansion', the definition of covered investment includes only those that have been admitted in accordance with national rules (Art. 4). In the IISD model treaty (Art. 4(E)), it is provided that nothing in the treaty creates a right of establishment.

In a few treaties, an express commitment to grant entry is provided.[14] The Canadian and US models adopt a different approach. The national treatment and MFN obligations in these treaties extend to the pre-establishment phase, creating a right of establishment for foreign investors from the other party to the treaty by requiring treatment of them by the host state that is no less favourable than that accorded to domestic investors and other foreign investors with respect to establishing their businesses in the host state market.[15] The right of access is not an absolute right, but one that allows access to sectors that are open to domestic investment. Such rights do not create a requirement, for example, to privatise activities that are reserved to the state or that are state-sanctioned monopolies.

Another approach that is more limited and specific is to adopt a provision that prohibits the maintenance or adoption of particular restrictions on market access, such as a maximum permissible percentage of foreign ownership of a business, and limitations on the number of firms allowed to participate in identified activities, a kind of limitation that favours incumbent firms that may be mostly local. This is the approach taken in the *GATS*.[16]

All IIAs that provide for rights of establishment limit their scope of application by expressly excluding particular sectors or permitting the maintenance of certain restrictions, such as investment-screening regimes. There are two main ways in which exclusions of this kind may be provided for in an IIA:

- **A *positive list* of the policy areas, sectors and measures to which the right of establishment obligation applies; and**
- **A *negative list* of policy areas, sectors and measures to which the right of establishment obligation does *not* apply.**[17]

In principle, negative listing is not inherently more restrictive than the positive list approach. A party could achieve the same level of committed sectors and measures using either approach. However, negative listing forces states to make an inventory of their restrictions and make them transparent by listing them. If a state fails to include a sector or measure on its list, the right of establishment obligation will apply. By

14 E.g. 1998 Framework Agreement on the ASEAN Investment Area, Art. 7(1).

15 Canadian model FIPA, Arts. 3 and 4; US model BIT, Arts. 3 and 4. Also investors eligible for protection are defined to include persons seeking to make an investment (Canadian model FIPA, Art. 1; US model BIT, Art. 1). These obligations apply to state treatment of investors related to the establishment and acquisition of investments. See UNCTAD (2003), *World Investment Report 2003*, at 102; Oxfam International (2003), *The Emperor's New Clothes: Why Rich Countries Want a WTO Investment Agreement*, Oxfam International Briefing Paper 46, at 25. See also WTO, *Communication from India*, Working Group on the Relationship between Trade and Investment (2 October 2002), Doc. No. WT/WGTI/150, at para. 4, where India noted in 2002 that apart from a BIT between Japan and Korea, only US and Canadian IIAs require pre-establishment national treatment. The Norwegian Draft model APPI also contains a right of establishment in Art. 4. Right of establishment provisions are becoming increasingly common.

16 *GATS* Art. XVI. See discussion of *GATS* in Appendix 2.

17 Positive and negative listing is common in relation to a wide variety of IIA obligations, as discussed below.

contrast, under a positive list approach, a state need only identify those sectors with respect to which it is prepared to undertake a commitment. Consequently, a positive approach is less administratively burdensome and more likely in practice to leave the state with greater residual policy-making flexibility.[18]

A negative list or 'opt-out' approach is the more common model where rights of establishment are provided for. The Canadian model FIPA and the US model BIT follow a negative list approach. For example, the Canadian model treaty contemplates that each party may exclude certain sectors and measures from the application of the national treatment, MFN and some other obligations through the use of reservations.[19] Canada routinely uses reservations to protect its foreign investment screening regime as well as other discriminatory measures from challenge under its IIAs.[20] The US model BIT contains a similar provision excluding the application of national treatment and MFN obligations to certain sectors, sub-sectors and activities listed in a schedule to the agreement.[21]

Under a positive list approach, a state commits to providing a right of establishment, but only for sectors that the state agrees to list, and only subject to reservations for any conditions that must be satisfied in order for access to be permitted.[22]

Other possible limitations on a right of establishment include the following:[23]

- **Agreeing to negotiate right of establishment commitments at a later date:** This approach may be desirable for countries whose foreign investment policy generally or for particular sectors is evolving. An alternative that would create greater certainty for investors would be to commit to a right of establishment on particular terms at a fixed date in the future.
- **Agree to a right or establishment but exclude this commitment from investor–state dispute settlement:** This has been done in some Canadian IIAs.[24]
- **Agree to a 'best endeavours' right of establishment:** This is not a binding obligation but is an expression of host state intention that may provide some comfort to investors.

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18 A third alternative would be to have a state commit to provide national treatment on a non-binding 'best endeavours' basis. This has been done in relation to pre-establishment commitments in some treaties such as the European Union–Morocco Association Agreement, signed 26 February 1996, in force 1 March 2000, Art. 31.

19 Canadian model FIPA, Art. 9.

20 E.g. Canada–Peru Free Trade Agreement, signed 29 May 2008, in force 1 August 2009. Additionally, in some agreements, disputes regarding the right of establishment are not subject to investor–state dispute settlement. E.g. Canada–Barbados, Agreement between the Government of Canada and Government of Barbados for the Reciprocal Promotion and Protection of Investments, signed 19 May 1996, in force 17 January 1997.

21 US model BIT, Art. 14.

22 The India–Singapore CECA (2005) provides for a right of establishment in listed sectors only (Art. 6.3(1)). This positive listing approach is followed in the IISD model treaty, Arts. 4 and 5.

23 This list is based on UNCTAD (2012), *Investment Policy Framework for Sustainable Development*, United Nations, New York and Geneva, at 61.

24 E.g. Canada–Barbados BIT (1997), Art. II.

5.2.2 Investor obligations and the right of establishment

As discussed below in the Guide, one way to help ensure that IIAs contribute to sustainable development is to impose obligations on investors (i) to comply with host state laws, (ii) to meet specific standards in relation to human rights, labour rights, indigenous peoples' rights, (iii) not to engage in bribery and corruption and (iv) to undertake sustainability assessments prior to making their investments.[25] If parties negotiating an IIA decide to include some or all of these provisions, some consideration will have to be given to when they should begin to apply. To be most effective, some obligations would have to start before an investment is admitted by the host state. For example, an obligation to undertake a sustainability assessment prior to making an investment would have to commence prior to host state admission of the investment if it were to have any effect. States may agree that treaty prohibitions on bribery and corruption should apply to a prospective investor during the host state's investment admission process to ensure that any bribery or corruption during that process is caught.

As noted above, most IIAs do not protect the investments of investors prior to the admission of the investment. For a treaty that follows this approach but contains investor obligations, it may be necessary to specify a different earlier commencement date for the investor obligations in the investor obligation provisions. For treaties that create investor protection obligations that operate at the pre-establishment phase, and impose investor obligations, the investor obligation provisions will still need to be drafted to make clear when each kind of obligation begins to apply.

Box 5.2 Summary of options for a right of establishment provision

1. *No right of establishment*
2. *Right of establishment subject to limitations*
   a. Limiting scope of right of establishment by specifying that only specific barriers to market access are prohibited;
   b. Positive list of sectors to which right of establishment obligation applies;
   c. Negative list of sectors to which right of establishment obligation does not apply;

(Continued)

25 See Sections 6.7 (Investor obligation to comply with the laws of the host state); 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence); 6.9 (Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights); 6.10 (Investor obligation to comply with core labour standards); 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption); 6.6 (Sustainability assessments).

(Continued)

d. Postponing right of establishment commitments to a fixed date or to be negotiated in the future; and

e. Limiting right of establishment commitments to 'best endeavours'.

3. *Unlimited right of establishment*

5.2.3 Discussion of options

Whether an IIA contains a right of establishment and, if it does, the scope of any permitted limitations are key issues that define the degree of openness secured by the treaty because the protection of pre-establishment rights limits the ability of the host state to use domestic law and regulations to keep out foreign investment. If the state does not have sufficient regulatory capacity to deal with the conduct of investors after their admission, it would be ill advised to grant a right of establishment, and no state gives foreign investors an unlimited right of establishment. To grant a limited right of establishment in an IIA, the host state must have a developed policy framework in place for the admission of foreign investments and be confident that its regime can be carved out of IIA in sufficiently broad terms to ensure not only that its existing policy and programmes are insulated from challenge, but also that foreseeable future changes to the policy may be made as necessary.

Whether a state should commit to granting a right of establishment in any of the forms identified above, even a best endeavours undertaking, is a matter that can be determined only by reference to the existing policy of the state on the admission of foreign investment. If a country has already adopted a policy of opening the domestic economy to foreign participation, the effect of an IIA provision guaranteeing that access would not require any change in government policy. Such a provision would, however, constrain a future return to a policy excluding or limiting foreign investment. As noted, it is precisely this limitation on future policy change by the host state that foreign investors hope to obtain from an IIA. Any retreat from the level of openness guaranteed by a right of establishment in an IIA could result in a claim for compensation by prospective investors under the treaty's investor–state arbitration procedure. If a state permits foreign investment on a limited basis, a commitment to a right of establishment in an IIA would represent a substantial liberalising policy shift for that state. The magnitude of the shift would depend on the precise terms of the commitment.

The Guide does not include a sample provision creating a right of establishment. As discussed above, only a few developed countries seek a right of establishment, and even for those that do, the right is always a qualified one. Also, the challenge of drafting adequate reservations (a negative list approach) or listing commitments (a positive list approach) to provide sufficient policy flexibility regarding the host state's right to refuse entry of foreign investors consistent with its existing and anticipated future foreign investment policy is significant and will be hard for many host states to meet, especially if their policy on permitting entry of foreign investors is not well

developed. As between a positive and a negative list approach, it is administratively simpler to use a positive list.

A right of establishment represents a strong commitment to foreign investors that may encourage investment from investors of the other party state and even from other states. If a right of establishment is desired, it could be set out in a specific section. It is often found in the national treatment and MFN provisions as described below.[26] Some of the options for dealing with a right of establishment are discussed below in relation to these provisions.

5.3 National treatment

Cross references

Section 4.3	Definitions	48
Section 5.4	Most favoured nation	124
Section 5.5	Fair and equitable treatment and the minimum standard of treatment	138
Section 5.12	Reservations and exceptions	224

A national treatment obligation in an IIA prohibits party states from treating foreign investors from other party states and their investments less favourably than domestic businesses and their investments. The purpose of a national treatment obligation is to protect foreign investors against arbitrary or unfair discrimination by host states in favour of domestic businesses. National treatment typically prohibits both differences in treatment that are expressed in a host state measure (called *de jure* discrimination) and those that result in practice from the operation of a state measure that is not in its express terms discriminatory (called *de facto* discrimination).[27] Regarding *de facto* discrimination, in order to show a breach of the national treatment obligation, it is not necessary to show discriminatory intent on the part of the state. The fact of less favourable treatment is generally sufficient.[28]

National treatment is one of the most significant obligations found in IIAs, in part because host state measures that discriminate in favour of domestic firms are common, often tied closely to national development goals and politically very sensitive. Most host states have some programmes that grant advantages exclusively to domestic businesses in order to encourage their growth and their ability to compete with foreign investors. While these kinds of programmes are most common in developing countries with less developed industries, virtually all states have some kinds of preferences for domestic businesses. No state grants national treatment to foreigners in every situation without qualifications.

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26 See Section 5.3 (National treatment) and Section 5.4 (Most favoured nation).

27 *ADF Group Inc. v. United States of America*, ICSID Case no. (AF)/00/1, Final Award, 9 January 2003, at para. 157.

28 *International Thunderbird Gaming Corporation v. Mexico*, UNCITRAL, Award, 26 January 2006; *Siemens v. Argentina*, ICSID Case No. ARB/02/8, Award, 6 February 2007. But see *Methanex v. US*, UNCITRAL, Final Award, 3 August 2005 at Part IV, Chapter B, para. 12.

This deceptively simple obligation can be quite difficult to apply in practice, especially in relation to host state measures that treat foreign investors differently for some legitimate policy reason. Its application often depends very much on the specific facts and some issues regarding the application of national treatment have not been fully resolved by existing arbitral cases.[29] Some options for ensuring that the national treatment obligation does not inappropriately constrain host states seeking to regulate to achieve legitimate policy objectives are discussed below.

5.3.1 National treatment is a relative standard

What national treatment requires is determined not by any objective norm, but by reference to the host state's treatment of its domestic businesses. This has three main implications.

- **If national treatment is agreed to, discrimination in favour of domestic investors or their investments by a host state must be either eliminated by the host state or excepted from the IIA obligation in some way, such as through a reservation or exception.** To the extent that the national treatment obligation requires states to remove discriminatory measures, it has a liberalising effect. Most other IIA obligations do not require liberalisation. Often, however, existing discriminatory measures are excluded from the agreement in some way.
- **Any new, more favourable treatment of domestic investors increases the minimum level of treatment that the host state must provide to foreign investors.** The level of protection for foreign investment may be ratcheted up in this way over time as the treatment of domestic investors improves. It is also the case that if a host state's treatment of its domestic investors worsens, the national treatment will only commit the host state to that lower standard. However, other IIA provisions, such as the fair and equitable treatment obligation, may limit states' ability to reduce the level of treatment of foreign investors in some circumstances, even where the treatment of domestic investors is worsened in some way.[30]

  It is important for countries considering negotiating an IIA to be aware that their obligations towards foreign investors under national treatment clauses will change over time with changes in their domestic regime. States need to bear the relative nature of the national treatment obligation in mind on an ongoing basis to ensure that they are in compliance with IIA national treatment commitments. In this regard, it is important to note that any difference in treatment is not always less favourable. In each case, the impact and purpose of the treatment by the host state must be considered.

29 R Dolzer and C Schreuer (2008), *Principles of International Investment Law*, Oxford University Press, Oxford, at 179.

30 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).

- **It is consistent with the national treatment obligation to treat foreign investors and their investments** *more favourably* **than domestic businesses.** The most common formulation of national treatment is to require treatment 'no less favourable than' that accorded to domestic businesses,[31] which makes clear the possibility of better treatment for foreign investors.

5.3.2 IIA practice

Most IIAs require party states to provide national treatment,[32] but not all do. The trend in recent IIAs, however, has been to include a national treatment obligation. The formulation of the national treatment standard varies. The Indian and UK model treaties simply require a party state to treat the investments of investors of other party states in a manner that is no less favourable than the treatment accorded to investments of that party's nationals.[33]

Others, such as the Canadian and the US model treaties, limit the obligation to investors and investments that are 'in like circumstances' and to certain identified activities. For example, Canada's basic national treatment obligation regarding foreign investments provides as follows:

> Every Party shall accord to covered investments of another Party treatment no less favourable than that it accords, *in like circumstances*, to investments of its own investors with respect to the *establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition* of investments.[34] (Emphasis added.)

The reference to 'in like circumstances' is intended to direct any interpreter of the provision, such as an investor–state tribunal, to ensure that the domestic investment whose treatment is chosen to compare with the foreign investor's investment is an appropriate comparator.[35] The reference in this provision to specific activities clarifies and defines the scope of the obligation. Both are discussed below.

Finally, the national treatment obligation set out above applies only to 'investments'. In the Canadian model, the national treatment obligation is expressed separately in

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31 UNCTAD (1999), *National Treatment*, United Nations, New York and Geneva, at 37. See, for example, the AALCC draft model BITs, Art. 5, models A and B.

32 E.g. Indian model BIPPA, Art. 4; UK model IPPA, Art. 3; ASEAN Agreement (2009), Art. 5. Some other countries have not always required national treatment in their IIAs (e.g. Australia).

33 In practice there has been some variation in the scope of the national treatment obligation in agreements entered into by the UK. In the United Kingdom–Belize, Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Belize on the Promotion and Protection of Investment, signed 30 April 1982, in force 30 April 1982, the obligation only applies to new measures introduced after the date of the treaty. The United Kingdom–Jamaica, Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Jamaica on the Promotion and Protection of Investments, signed 20 January 1987, in force 14 May 1987, permits 'special incentives' to nationals that do not significantly affect the investment and activities of the foreign investor in connection with the investment.

34 Canadian model FIPA, Art. 3(2).

35 For a more extensive discussion of the issues related to national treatment, see UNCTAD (1999), *National Treatment*, op. cit.

relation to 'investors' of the other party state.[36] Most national treatment obligations apply to both investors and their investments. Some obligations are expressed to apply only to investments. As discussed above, both investment and investor are extensively and carefully defined in IIAs.[37] Consequently, the failure to refer to investors might significantly limit the scope of the treaty and would reduce its benefit to foreign investors correspondingly. For example, a treaty that applied only to investments would not cover directly the treatment of foreign natural and legal persons of the other party but only of the investments they make. The distinction between the protection of investments and investors has not, however, been a significant issue in investor–state arbitration cases to date.[38]

5.3.3 The basis of comparison and 'in like circumstances'

The purpose of the national treatment obligation is to prohibit discrimination based on nationality. Consequently, measures that expressly state that foreign investors in identified categories are to be treated differently from identified categories of domestic businesses will generally be found to be a breach of the national treatment obligation if the treatment of foreign investors is less favourable. An investor–state tribunal would also have to be satisfied that the domestic investor alleged to be favoured by the measure was truly comparable to the foreign investor claiming a breach of national treatment. Where a government measure does not expressly prescribe discriminatory treatment and an investor argues that it is being treated differently and less favourably in fact (*de facto* discrimination), it is necessary to identify the appropriate domestic business to compare with the foreign investor to evaluate their relative treatment. Choosing an appropriate comparator has proven difficult in practice.

In most cases, for example, it would not be appropriate to compare the treatment of a foreign investor with a domestic investor in a different economic sector or of a very different size. While finding the right comparator is an inherent requirement of applying a national treatment obligation, many treaties, like the Canadian model mentioned above, direct an interpreter of the provision to investigate whether the foreign investor and a domestic investor alleged to have received more favourable treatment are truly comparable by specifying that they be 'in like circumstances'.[39]

A requirement that the foreign investor be 'in like circumstances' with the domestic investor in order for national treatment to apply helps to make clear that governments have scope to treat foreign investors differently from domestic businesses where doing so is necessary to achieve some legitimate public policy objective. In *Pope & Talbot*, an arbitral decision under NAFTA's investment chapter,[40] the tribunal had to determine

36 Canadian model FIPA, Art. 3(1).

37 See Section 4.3 (Definitions).

38 UNCTAD (2010), *Most Favoured Nation Treatment: A Sequel*, United Nations, New York and Geneva, at 104.

39 The UK model IPPA uses the same language. The UK–Belize BIT (1982), however, refers to 'in the *same* circumstances' (emphasis added), a stricter standard, meaning that fewer domestic businesses would be appropriate comparators.

40 NAFTA (1992), op. cit.

whether foreign and Canadian investors that were treated differently were in like circumstances with respect to the allocation of an export quota. The tribunal asked whether the difference in treatment was justified by a rational policy objective that was not based on a preference favouring domestic investors over foreign investors and did not unduly undermine the investment-liberalising objectives of NAFTA. The tribunal held that if the difference in treatment could be justified on this basis, then the foreign and domestic investors were not 'in like circumstances' for the purposes of the measure.[41] As a result, there could be no breach of the national treatment obligation.[42] The overall purpose of the enquiry is to ensure that the national treatment obligation is applied only to prevent discrimination on the basis of the foreign nationality of the investor or investment. In the Norwegian draft model agreement, as well as including a reference to 'in like circumstances,' a footnote was added reciting the parties' agreement to a standard for differential treatment that is similar to the test set out in *Pope & Talbot*.

The IISD model treaty also contains an 'in like circumstances' qualification, but goes on to expressly require the following factors to be taken into account when determining whether investors are 'in like circumstances':

- The effect of the investment on third persons and the local community;
- The effect of the investment on the local, regional or national environment or the global commons, including effects relating to the cumulative impact of all investments within a jurisdiction;
- The sector in which the investor operates;
- The goal of the alleged discriminatory measure;
- The regulatory scheme applied to the investor; and
- Other factors directly related to the investment of the investor in relation to the measure concerned.[43]

The IISD model directs interpreters of the treaty to give equal consideration to all factors, rather than favouring some over others. This approach, which has been adopted in the COMESA Investment Agreement,[44] is intended to ensure that the application of the national treatment obligation takes into account development and other

41 *Pope & Talbot v. Canada*, UNCITRAL, Award on Merits of Phase 2, 10 April 2001, at para. 79, applying the approach in OECD (1993), *Declaration on National Treatment for Foreign-controlled Enterprises*, OECD, Paris, at 22. See similarly *S D Myers Inc. v. Canada*, UNCITRAL, Partial Award, 13 November 2000, at para. 246, and *In the Matter of Cross-Border Trucking Services*, (USA-Mex-98-2008-01), Final Report of the Panel, 6 February 2001 at para. 258.

42 Some commentators suggest that this is an inherent limitation on the national treatment obligation, such that different treatment is never a breach of national treatment if rational grounds are shown for the difference. Dolzer and Schreuer describe this as 'widely accepted' but acknowledge that 'a precise definition of these grounds remains elusive' (Dolzer and Schreuer (2008), op. cit., at 181).

43 IISD model treaty, Art. 5(E).

44 COMESA Investment Agreement (2007), Art. 17. Under the COMESA Investment Agreement (2007) national treatment does not apply to certain sectors listed by each member state (Art. 18).

policy priorities as well as investment policy considerations in determining whether domestic and foreign investors are in like circumstances. Moreover, this approach avoids the approach adopted by tribunals in some investor–state cases, under which domestic and foreign investors are assumed to be in like circumstances simply because they are in the same sector or industry and consequently the host state is required to explain how the domestic and foreign investors are not in like circumstances. Such an approach places the burden on the host state to justify treating investors differently. Box 5.3 provides an example of how 'in like circumstances' can be applied to protect the policy-making flexibility of host states.

Box 5.3 Example of 'in like circumstances'

A host state enacts a measure to protect the environment by limiting use of a particular highly polluting industrial technology. In practice, foreign investors in the state are the only users of that technology. Domestic businesses in the same sector do not use the polluting technology. They use another technology that has much less serious environmental effects.

The foreign investors are not 'in like circumstances' with the domestic businesses for the purposes of the achievement of environmental protection objective of the measure and the measure is not a breach of national treatment.

Determining what is an appropriate domestic business to compare to a foreign investor is a complex and fact-specific enquiry. As a result, it is difficult to make reliable generalisations regarding what will be considered an appropriate comparison for the purposes of applying the national treatment standard. Nevertheless, one can say that there is nothing in the expression of the standard or the arbitral cases that requires a tribunal to compare the treatment of a foreign investor to the treatment of all domestic businesses in a particular sector as opposed to a particular domestic business or group of businesses. There is no hard and fast rule that all foreign investors must be given the best treatment given to any domestic investor in the host state or treatment that is no less favourable than the average treatment of domestic investors.

5.3.4 Limiting national treatment to specific matters, including pre- and post-establishment activities

National treatment applies only to matters governed by the treaty, specifically the treatment of investors and their investments. It does not extend to other matters, such as maritime shipping rules, except to the extent that they affect investors and their investments. Similarly, national treatment does not apply to tax matters if tax matters are excluded from the treaty.[45]

45 This is an example of the *ejusdem generis* principle of interpretation. Regarding the application of this principle in the MFN context, see ILC, Draft Articles on MFN, Report of the Commission on the Work of the Thirtieth Session, UN Doc.A/33/10, Yearbook of the International Law Commission, 1978 (Arts. 9 and 10).

Some states have agreed to limit the application of the national treatment obligation to specific matters. The national treatment obligation in the Netherlands–Jamaica BIT applies only to measures related to 'taxes, fees, charges and exemptions'.[46] The Canadian and US model agreements also limit the scope of the national treatment obligation to treatment relating to particular activities: 'the establishment, acquisition, management, conduct, operation, expansion and sale or other disposition of investments in its territory'.[47] This language makes clear that national treatment only applies to measures affecting these aspects of investments and helps to make the scope of the provision's application more predictable.

By referring to terms such as 'establishment', 'acquisition' and 'expansion', however, the national treatment obligation creates a right of establishment for foreign investors.[48] They must be treated no less favourably than domestic investors with respect to being allowed to operate in the host state. A national treatment obligation that does not include those kinds of words does not create a right of establishment, so long as the IIA makes clear that it applies only to investments admitted by the host state in accordance with its domestic regime. In general, pre-establishment rights are sought in order to achieve some actual liberalisation of conditions of entry to the host state, though a commitment to pre-establishment national treatment also obliges host states not to change the existing rules in ways that restrict entry. Pre-establishment rights are always accompanied by exclusions, usually in the form of reservations, to protect the host state's right to discriminate in specific sectors or through particular measures, typically reflecting existing state policy.[49]

If the parties to an IIA do not intend to create a right of establishment, in addition to omitting words such as 'establishment', 'acquisition' and 'expansion' from the national treatment provision, it is important to include a provision stating that the agreement applies only to investments admitted by a state in accordance with its laws and regulations. An example of such a provision is provided in the Guide sample scope provision.[50]

5.3.5 Excluding particular sectors or measures from national treatment

It is possible to limit the scope of a national treatment obligation to exclude particular sectors or measures with respect to which a host state does not want to be bound. As

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46 Netherlands–Jamaica BIT (1991), Art. 4, though Art. 3 contains a broader non-discrimination provision.

47 Similar language is used in the Draft Norwegian APPI, Art. 3. Prior to 2004, the Canadian model treaty did not allow investors to initiate investor–state dispute settlement on the basis of a claim that national treatment had not been provided in relation to establishment or acquisition of a business.

48 Expansion includes an investment of new foreign capital to expand an existing business carried on by an investor. Similarly, acquisition includes acquisitions financed by new foreign capital. However, an expansion or acquisition would also include transactions or activities financed entirely in the host state. If an IIA contains a clear admission clause that ensures that any new investment must meet domestic requirements for admission, then expansion and acquisition could be included in the list of activities to which the obligation applies without creating a right of establishment; e.g. ASEAN Agreement.

49 See Section 5.2 (Right of establishment).

50 See Section 4.5 (Scope of application).

noted, most states have some preferential arrangements for local businesses. The Canadian model adopts a negative list approach to protect domestic preferences from the agreement. It permits each party state to exclude sectors and measures from the application of the national treatment and some other obligations by including them in a list of reservations.[51] The US model BIT contains a similar provision excluding the application of national treatment and some other obligations to certain sectors, subsectors and activities listed by each party in a schedule.[52] By contrast, the India–Singapore CECA takes a positive list approach to national treatment. The national treatment obligation is limited to sectors listed by each country.[53] All other sectors are excluded.

Another way to exclude sectors or measures from the scope of an IIA is to include general exceptions. Unlike reservations, exceptions operate for the benefit of both parties. It is increasingly common to have general exceptions to the national treatment obligation that protect measures in certain policy areas, such as health and the environment.[54] It may also be desirable to include an exception tailored to development. An example is found in the Italy–Morocco BIT.

> Investors of the two Contracting Parties shall not be entitled to national treatment in terms of benefiting from aid, grants, loans, insurance and guarantees accorded by the Government of one of the Contracting Parties exclusively to its own nationals or enterprises within the framework of activities carried out under national development programs.[55]

Such a broad exception creates significant uncertainty for foreign investors regarding whether they may rely on the national treatment obligation in relation to particular state actions. Such uncertainty might discourage investment. Also, it might be argued that such a development exception is not necessary to the extent that, for the purposes of a policy supporting local development, foreign and domestic investors will not be found to be in like circumstances. In the absence of some clear indication that discriminatory development policies are permitted, however, it is difficult to be confident that an investor–state arbitration tribunal would accept such an argument. As a consequence, some form of express exception may be needed to make sure that a host country has the flexibility to pursue its domestic policy. Exceptions that provide discrete lists of sectors and activities that are excluded from the scope of the national treatment obligation provide greater certainty to investors than a general development exception, but a general exception provides more flexibility for host states.[56] Examples of specific exceptions from the national treatment obligation for

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51 Canadian model FIPA, Art. 9.

52 US model BIT, Art. 14.

53 India–Singapore CECA (2005), Art. 6.3(1).

54 See Section 5.12 (Reservations and exceptions).

55 Morocco–Italy, Agreement between the Government of Morocco and Government of the Italian Republic on the Promotion and Protection of Investments, signed 18 July 1990, in force 1 January 1992, Art. 3(3). See also the Netherlands–Jamaica BIT (1991), Art. 3(6). The ASEAN–Australia–New Zealand Free Trade Agreement has a different approach focusing on special and differential treatment (Art. 15).

56 UNCTAD (1999), *National Treatment*, op. cit., at 65.

government subsidies and government purchases of goods and services (often referred to as 'government procurement'), two common types of discriminatory policies maintained by host states, are provided below.[57]

5.3.6 The scope of the national treatment obligation as it applies to sub-national governments

As noted, a state is responsible for compliance by sub-national governments with its IIA obligations in the absence of a reservation or exception.[58] With respect to the application of national treatment to sub-national government measures, one of the issues is whether sub-national governments must grant foreign investors the same treatment they give to local investors within their sub-national region or whether it is sufficient if they grant the same level of protection that they accord to other domestic investors from outside the region.

In the Canadian model FIPA and the US model BIT, sub-national governments are obliged only to provide treatment that is no less favourable than the treatment that they grant to domestic investors from other parts of the country. Such a special national treatment obligation for sub-national governments permits them to discriminate in favour of local businesses and against foreign investors so long as the treatment given is at least as good as that given to investors from other parts of the country. In the absence of such a provision, an argument could be made that the category of national investors that constitutes the appropriate group for comparison with foreign investors for the purpose of national treatment is local investors within the region. If such an argument were successful, a sub-national government would have to give foreign investors no less favourable treatment than it gives to local businesses, even if such treatment were better than that given to other national investors of the host state from other parts of the country.

Investors will want to receive treatment by a sub-national government that is no less favourable than local investors from within the jurisdiction of the government. Host states, however, may not want to impose such a strict national treatment obligation on sub-national governments for political or other reasons. Sub-national governments may have limited awareness of IIA obligations or be unwilling to comply with them. Whether national governments can compel compliance by sub-national governments with IIA obligations will depend on each country's constitutional system and its politics. The importance of the issue will depend on the extent to which sub-national governments in the host state have the power to act in ways that will affect investors.

5.3.7 Interaction between national treatment and MFN

The national treatment obligation interacts with MFN obligations in an IIA in two important ways:[59]

57 See Section 5.12 (Reservations and exceptions).

58 See Section 4.5 (Scope of application).

59 Possible interactions are discussed in UNCTAD (1999), *National Treatment*, op. cit., at 55–60.

- **Where both standards are present in an IIA, one issue is which prevails in the event of a conflict**: Some agreements, such as NAFTA, expressly provide that the higher standard prevails.[60] In the absence of such a provision, it is likely that this is the most appropriate interpretation. Both provisions would be given effect.
- **Could an IIA that does not explicitly include a promise of national treatment, but that does provide for MFN, be interpreted to impose a national treatment obligation on a party if the party has agreed to a national treatment commitment in another agreement?** As discussed below, this kind of incorporation in a treaty of provisions from other treaties is possible in some circumstances.[61]

Box 5.4 Summary of options for a national treatment provision

1. *No national treatment obligation.*
2. *A post-establishment national treatment obligation that may be limited in one or all of these ways:*
   a. To specific activities (and *not* including activities such as establishment, acquisition or expansion);
   b. To foreign investors 'in like circumstances';
   c. To listed policy areas, sectors and measures (positive list) or excluding listed policy areas, sectors and measures (negative list);
   d. With respect to sub-national governments, to treatment no less favourable than such governments extend to other investors of the host state from outside the jurisdiction of sub-national governments;
   e. Subject to general exceptions; and
   f. To *de jure* national treatment, excluding *de facto* national treatment.
3. *A pre-establishment national treatment obligation that may be limited in the same ways as discussed in option 2.*

5.3.8 Discussion of options

1. *No national treatment obligation*

Most IIAs contain a national treatment obligation. It provides significant protection to foreign investors against discrimination in favour of domestic businesses which may be valued by them. Without such an obligation, host states have discretion to

60 NAFTA (1992), Art. 1104.
61 See Section 5.4 (Most favoured nation).

treat foreign investors differently. Some other obligations typically found in IIAs, including a prohibition on expropriation without compensation and the fair and equitable treatment obligation, may operate to prohibit discriminatory actions by host states.[62]

It is possible that an IIA could contain an obligation to grant national treatment but only subject to domestic law of the host state. In effect, this would not commit the host state to grant national treatment but only to ensure that any discrimination was authorised by law.

If an IIA does not contain a national treatment obligation, but (i) the IIA contains an MFN obligation and (ii) the state had entered into another IIA that provided a national treatment obligation, it is possible that an obligation on the state to provide national treatment would be incorporated into the IIA through the MFN obligation.

2. *A post-establishment national treatment obligation limited in one or all of these ways*

    a. Limited to specific activities (and *not* including establishment, acquisition or expansion)

This approach to drafting an IIA provision clarifies the scope of the obligation by limiting it to identified activities for the benefit of both investors and host states. Many IIAs refer to activities to which the obligation applies, such as the conduct, operation, and sale or other disposition of the investment.

    b. Limited to foreign investors 'in like circumstances'

A reference to 'in like circumstances' directs a tribunal to make sure that it considers a variety of factors to determine what domestic businesses should be compared to the foreign investor for the purposes of applying the national treatment obligation. Some view the national treatment obligation as inherently requiring such a determination, whether it refers to 'in like circumstances' or not. An express reference to 'in like circumstances' provides more certain direction to interpreters. An analysis of 'in like circumstances' that takes into account the purpose of the measure provides more scope for a state to engage in policies for non-discriminatory purposes that may have a negative effect on foreign businesses. This is because, for the purposes of a particular policy, a foreign investor and a domestic business may be found not to be in like circumstances. A national treatment obligation can provide even more direction to an interpreter of the obligation by identifying possibly relevant circumstances that should be taken into account to determine if a foreign investor and a domestic business are in like circumstances.

62 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment) and Section 5.6 (Limitations on expropriation and nationalisation).

c. Limited to listed policy areas, sectors and measures (positive list) or excluding listed policy areas, sectors and measures (negative list)

Most IIAs exclude the application of the national treatment obligation to some policy areas, sectors or measures to reflect preferences for local businesses in existing national rules and in sectors or areas of policy where a state wants to be able to discriminate against foreign investors in the future. A negative list approach requires a state to list a policy area, sector or measure if the obligation is to be avoided. A positive list approach requires a state to list a sector or measure for the obligation to apply. Positive listing is a less burdensome approach because it is not necessary to list sectors or measures to avoid the application of the national treatment obligation and it may result in a narrower scope of application for the obligation. It also means, however, that restrictions are not transparent to investors.

d. With respect to sub-national governments, limited to treatment no less favourable than such governments extend to other investors of the host state from outside the jurisdiction of sub-national governments

In the absence of an exception or reservation, the national treatment obligation applies to measures of sub-national governments. The Canadian and US model agreements create a relaxed national treatment obligation for sub-national governments that permits them to discriminate in favour of local businesses and against foreign investors so long as the treatment given is at least as good as that given to investors from other parts of the country. This may be desirable for some states. Depending on the importance of sub-national governments in the regulation of economic activity, such a limitation might be a concern for investors.

e. Subject to general exceptions

Exceptions can be used to carve out areas of state policy-making from the application of the national treatment obligation and are being increasingly used in IIA practice. Common exceptions from the national treatment obligation are government preferences for local businesses in extending subsidies or buying goods and services. Exceptions limit the benefits of the obligation for investors.

f. Limited to *de jure* national treatment

A final option to limit the scope of a national treatment obligation is to limit the national treatment obligation to state measures that are *de jure* discrimination. In other words, only measures that expressly discriminate based on the foreign nationality of investors would be prohibited. This approach would create a clear and predictable obligation, though one that is very limited in its scope. It is not an approach that is followed in any IIA currently. One of the concerns that investors would have is that it is often difficult to distinguish between measures that are *de jure* and those that are only *de facto* discriminatory. A specific concern in this regard would be that governments could draft measures that avoided language that was discriminatory, but then apply the measure in a discriminatory way. If an IIA prohibited *de jure* discrimination only, there would be no breach of the treaty in these circumstances.

3. *A pre-establishment national treatment obligation limited in the same ways as discussed in option 2*

A pre-establishment national treatment obligation means that foreign investors must be treated no less favourably than domestic businesses with respect to entry into the host state market to carry on business. If specific activities to which the obligation applies are listed, they will include activities such as establishment, acquisition and expansion of the investment that relate to entry into the host state's market. Reservations can be used to carve out any specific entry restrictions for foreign investment that a state wants to maintain, or sectors of activity to which the obligation does not apply. Alternatively, positive listing of sectors subject to the pre-establishment national treatment obligation could be used.

With respect to options 2 and 3, if (i) a state has imposed limitations on the scope of the national treatment obligation in an IIA, (ii) the IIA contains an MFN obligation and (iii) the state has entered into another IIA that contains a national treatment provision without these limitations, it is possible that the more favourable national treatment obligation will be incorporated into the treaty through the MFN obligation.

5.3.9 Discussion of sample provision

A national treatment obligation provides assurance to foreign investors that they will encounter a level playing field when they do business in the host state. It prohibits nationality-based discrimination. Some form of national treatment obligation is found in most, but not all, IIAs. Any limitation on the scope of national treatment will impair the benefit of the provision for investors.

In the sample provision, the national treatment obligation is qualified by reference to 'in like circumstances' to ensure that in applying the provision an appropriate comparator is sought. In general, this may help to ensure that host states have the right to pursue legitimate policy objectives even if the way that they do so incidentally results in a foreign investor being treated less favourably than a national. This approach is followed in many recent agreements other than those negotiated by some European countries. As in the IISD model agreement, a non-exhaustive list of factors to be taken into account in determining if investors are 'in like circumstances' is set out. While this is not an approach followed in existing agreements (other than in the COMESA Investment Agreement), it incorporates the general approach applied in a number of arbitration cases where tribunals have determined that in order to compare what is comparable it is necessary to take into account all relevant factors.[63] For further certainty, a version of the test developed in *Pope & Talbot* is included. A state measure that treats investors of the other party or their investments less favourably than its own investors or their investments is not inconsistent with the national treatment obligation if it is applied by the state in pursuit of a legitimate non-discriminatory public purpose and has a reasonable connection to the purpose.

The clarifying language from the Canadian and US models regarding the aspects of investments that are subject to the national treatment commitment has been

63 UNCTAD (2010), *Most Favoured Nation Treatment*, op. cit., at 26–7.

incorporated in the sample provision, except that words such as 'establishment', 'acquisition' and 'expansion' have not been included. If party states desire to create a right of establishment, words such as these should be included in the agreement. While an increasing number of treaties provide a right of establishment, most do not.

The Guide sample definition provision provides that sub-national governments are to be defined by each party in the definition section.[64] The sample national treatment provision clarifies and limits the obligations of sub-national governments in the same way as in the US model. Sub-national governments are obliged only to provide treatment that is no less favourable than the treatment that they grant to domestic investors from other parts of the country. Such a special national treatment obligation for sub-national governments permits them to discriminate in favour of local businesses and against foreign investors as long as the treatment given is at least as good as that given to investors from other parts of the country. With respect to legal persons, the sample provision permits discrimination in favour of locally incorporated or organised enterprises. Any other basis of discrimination in favour of locally organised businesses (such as discrimination based on the location of the operations of the business within the territory administered by the sub-national government) would not be protected.

Other sample provisions in the Guide provide examples of general exceptions and country-specific reservations applicable to the national treatment obligation, including specific exceptions for subsidies and government procurement.[65] Both may be necessary, especially if a negative list approach is followed. As noted, an alternative would be for the national treatment obligation to apply only to sectors and measures that a state had positively agreed to list. This option is provided for in brackets in the sample provision.

5.3.10 Sample provision: national treatment

National Treatment

1. Every Party shall accord to investors of the other Party and their investments treatment no less favourable than that it accords, in like circumstances, to its own investors and their investments with respect to the management, conduct, operation, and sale or other disposition of investments in its territory.

2. The treatment accorded by a Party under section 1 means, with respect to a sub-national government, treatment no less favourable than the treatment that the sub-national government accords, in like circumstances, to investors and to investments of investors of the Party of which it forms a part who are: (i) natural persons who are not residents in the territory administered by the sub-national government; or (ii) enterprises that are not incorporated or organised under the law of the sub-national government.

3. For greater certainty

64 See Section 4.3 (Definitions).
65 See Section 5.12 (Reservations and exceptions).

a. A determination of whether an investment or an investor are in like circumstances for the purposes of this article shall be made based on an assessment of all of the circumstances related to the investor or the investment, including:

   i. The effect of the investment on

      A. the community;

      B. the human rights of individuals and rights of indigenous peoples;

      C. the environment, including effects that relate to the cumulative impact of all investments within a jurisdiction;

   ii. The business sector in which the investor operates;

   iii. The goal of the alleged discriminatory measure; and

   iv. The regulations that apply to investments or investors;

b. A measure of a Party that treats investors of the other Party or their investments less favourably than its own investors or their investments is not inconsistent with this article if it is adopted and applied by the Party in pursuit of a legitimate public purpose that is not based on the foreign nationality of investors, including the protection of health, safety, the environment and internationally and domestically recognised human rights, labour rights or rights of indigenous peoples, or the elimination of bribery and corruption, and it bears a reasonable connection to the purpose.

[4. This article shall apply only to measures that a Party adopts or maintains with respect to sectors, sub-sectors or activities, as set out in its schedule to Annex 1 of this agreement.]

5.4 Most favoured nation (MFN)

Cross references

Section 4.5 Scope of application 94
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Section 7.1 Investor–state dispute settlement 408

A commitment to MFN in an IIA means that each party state commits to treating investors of the other party state and their investments no less favourably than it treats investors and investments of any other country. The investors that are the beneficiaries of an MFN commitment are assured that if other foreign investors are given treatment of a particular kind by the host state, their treatment should be no worse. The main goal of an MFN provision is to ensure equality of competitive opportunity among investors of different nationalities. The MFN obligation can be a key IIA provision

for smaller developing countries, if it permits their investors to benefit from stronger commitments negotiated by other countries with more bargaining power.[66]

Like national treatment, MFN typically prohibits both differences in treatment that are expressed in a host state measure (*de jure* discrimination) and those that result in practice from a state measure that is not discriminatory on its face (*de facto* discrimination).[67] With respect to *de facto* discrimination, in order to show a breach of the MFN obligation, generally it is not necessary to show discriminatory intent on the part of the state. Less favourable treatment by the state is sufficient.

Many of the issues related to MFN provisions are the same as those related to national treatment:

- Does the obligation create pre-establishment rights, meaning that it protects investors before they have entered the host country with their investments?
- How should an appropriate comparator with a foreign investor be identified in order to assess whether there has been a breach of the obligation?
- Should the obligation be limited to specific activities?
- Should particular policy areas, sectors or measures be excluded from the obligation and should this be done on a positive list or a negative list basis?

Since these issues have been previously discussed in the section on national treatment, they will be only briefly discussed in this section.[68]

Controversy has arisen around the extent to which an MFN provision in one IIA can be used to incorporate treaty standards from *other* IIAs. In fact, this has been the issue in most investor–state arbitration cases dealing with MFN, rather than the level of treatment given by the host state to investors from different states under its domestic law. Investors now frequently claim that the presence of an MFN clause in an IIA between their state and a host state means they should be able to take advantage of the highest level of investor protection that a host state has agreed to in any treaty, rather than the specific level of protection negotiated between the investor's state and the host state. The failure by investor–state tribunals to take a consistent approach regarding this issue has contributed significantly to the challenge countries face in trying to predict the scope of their obligations and act accordingly. Much of the discussion in this section will focus on this issue.

5.4.1 MFN is a relative standard

Like national treatment, MFN is a relative standard. In the case of MFN, what the obligation requires is determined by reference to the host state's treatment of other

66 See Government of Canada (2002), 'Canada's Foreign Investment Protection and Promotion Agreements (FIPAs) Negotiating Programme 2002', available at: www.bilaterals.org/spip.php?page=print&id_article=497 (accessed 25 May 2012).

67 *ADF v. US*, op. cit., at para. 157.

68 See Section 5.3 (National treatment).

foreign investors. As a result, any new, more favourable treatment of foreign investors increases the level of treatment that the host state must provide to foreign investors who are protected by an MFN obligation, subject to any applicable exception or reservation. The level of protection for foreign investors who benefit from an MFN provision may increase over time as the treatment of foreign investors from other countries improves. The effective impact of MFN tends to be much less significant in practice than national treatment, however, because most countries do not have policies that protect foreign investors from one country and not others that are as important or politically sensitive as the policies that protect domestic businesses. As discussed below, an important exception to this generalisation is the preferential treatment given by many countries under bilateral and regional trade and investment agreements.

Finally, it is important to note that different treatment of foreign investors will not always be less favourable. In each case, the impact of the treatment by the host state on a particular investor must be assessed to determine if it is less favourable.[69]

5.4.2 IIA practice

Almost all IIAs require that MFN treatment be provided, though a few do not.[70] The India–Singapore CECA, for example, does not include an MFN provision.[71] As noted, despite their common presence in IIAs, MFN provisions are less significant than national treatment obligations because of the relatively limited incidence of host state discrimination between foreign investors based on nationality.[72] As a result, states may decide that the simplest way to avoid some of the problems with MFN provisions discussed below is simply not to include an MFN obligation in their IIAs.

As with the national treatment standard, the MFN obligation in some treaties simply requires treatment no less favourable than that provided to investments and investors of other states.[73] The MFN obligation in other treaties is qualified in that it only applies to specified aspects of an investment, and requires MFN treatment only if foreign investors from different states or their investments are 'in like circumstances'.[74] The Canadian and US model treaties follow this approach. For example, the US MFN obligation related to investments provides as follows:

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69 In addition, UNCTAD has pointed out that the MFN obligation does not prevent preferences being granted to a foreign investor by contract that are not given to others. One explanation offered for this result is that a foreign investor who was not awarded a contract is not in like circumstances with the one that was (UNCTAD (2010), *Most Favoured Nation Treatment*, op. cit.).

70 In a recent study, UNCTAD found that approximately 80 per cent of the IIAs reviewed contained MFN provisions (UNCTAD (2010), *Most Favoured Nation Treatment*, op. cit.).

71 See, similarly, the India–Korea Free Trade Agreement, signed 7 August 2009, in force 31 December 2009, and the ASEAN–Australia–New Zealand FTA (2009) Investment Chapter, though there is a commitment to seek to negotiate an MFN commitment in the work programme established by the latter agreement (Art. 16).

72 Discrimination in the form of preferential agreements is common but this particular form of discrimination is usually permitted through a specific reservation or exception.

73 E.g. Indian model BIPPA, Art. 4; UK model IPPA, Art. 3.

74 E.g. Canadian model FIPA, Art. 4; US model BIT, Art. 4.

> Each Party shall accord to covered investments treatment no less favourable than that it accords, in like circumstances, to investments in its territory of investors of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.[75]

The purpose of the MFN obligation is to prohibit discrimination based on nationality. Consequently, measures that expressly state that foreign investors from one state are to be treated differently from foreign investors in another state will generally be found to be a breach of the MFN obligation if the treatment of foreign investors that benefit from that obligation is less favourable. Where such *de jure* discrimination is claimed by an investor, the issue for an investor–state tribunal will be whether the foreign investor that is discriminated against under the measure is being treated less favourably. A government measure does not need to prescribe discriminatory treatment on its face, however. An investor that is being treated differently and less favourably in fact (*de facto* discrimination) may also claim a breach of MFN. With claims of *de facto* discrimination, it is necessary to identify a foreign investor to compare with the foreign investor who is claiming less favourable treatment. Conceptually, the same challenges arise in finding an appropriate comparator as were discussed above in relation to national treatment.

In practice, finding the right comparator has not proved so difficult in relation to MFN. Nevertheless, in terms of drafting, the same considerations apply. Many IIAs include a direction to interpreters to ensure that they identify foreign investors that are truly comparable to a foreign investor who claims to have been less favourably treated by limiting the application of the MFN provisions to investors that are 'in like circumstances'. As with national treatment obligations, MFN obligations that contain 'in like circumstances' qualifications may provide more regulatory freedom for host states than obligations that are not restricted to investments and investors that are in like circumstances by ensuring that investor–state tribunals consider more carefully what is an appropriate foreign investment to compare with the foreign investment whose treatment is at issue. The need to find an appropriate comparator and the role of a reference to 'in like circumstances' were discussed above in Section 5.3 (National treatment). Since, essentially, the same issues arise for MFN as for national treatment, these issues will not be further discussed here.

5.4.3 Limiting MFN to specific matters, including pre- and post-establishment activities

As with national treatment, a key question is whether an MFN obligation applies in the pre-establishment stage of an investment or only after the investment has been admitted and established in accordance with the laws and regulations of the host state. As discussed above, most IIAs apply only post-establishment. States remain free to determine the conditions for entry of foreign investments and may change those conditions over time. Typically, this right is expressly preserved by an admission clause.[76] Once an investment has been admitted, the MFN obligation applies to

75 US model BIT, Art. 4(2). The same obligation is extended to investors as well (Art. 4(1)).
76 See Section 4.5 (Scope of application).

its treatment for the duration of its life. Some treaties, such as those negotiated by Canada and the USA, apply MFN to the pre-establishment phase of an investment, creating, along with the national treatment obligation, a right of establishment.[77] In the case of the MFN obligation, the right is only to permit establishment on terms no less favourable than those accorded to investors of other states. This would not create a right to enter the host state market for a foreign investor from a party state to an IIA unless other foreign investors were permitted to enter. Even then, the obligation would only be to treat foreign investors from the IIA party state no less favourably than investors from non-party states. No absolute right of entry is created. Often pre-establishment rights are sought in order to achieve some actual liberalisation of conditions of entry to the host state, as well as to obtain a commitment not to change existing rules in ways that restrict entry.

As with national treatment, the application of the MFN obligation to the pre-establishment stage is achieved by identifying the specific activities to which MFN applies and including those that are related to entry into the host state market. For example, the content of the MFN provision in the US model BIT set out above is limited to 'investments in its territory of investors of any non-Party with respect to the *establishment, acquisition, expansion*, … of investments' (emphasis added). When this is combined with a national treatment obligation that also applies to these activities related to market entry, a right of establishment is created.[78]

As noted in Section 5.3 (National treatment), it is common to exclude particular sectors or measures from national treatment using either limited commitments through a positive list approach or reservations from a general commitment using a negative list approach.[79] General exceptions may also apply. The same issues arise under MFN and the same options for dealing with them are used in IIAs. For a discussion of these issues refer to Section 5.3 (National treatment).

5.4.4 Importation of standards from other treaties

One of the most controversial issues regarding MFN clauses is the extent to which they import standards of behaviour and even rules of investor–state dispute settlement from other treaties into a treaty that includes an MFN provision. To the extent that they do so, investors protected under an IIA with a state that contains an MFN clause are entitled to the most favourable protection provided under *any* treaty the state has signed. In the arbitral decision in *Maffezini v. the Kingdom of Spain*,[80] for example, it was held that, subject to certain limitations, an MFN obligation may apply to treaty-based dispute settlement procedures, with the result that an investor protected by an

77 E.g. Canadian model FIPA, Art. 4; US model BIT, Art. 4.

78 The US model BIT provides only one example of how to create pre-establishment rights. Creation of pre-establishment rights can be achieved using different words.

79 In a few IIAs, states do not agree to grant MFN treatment in some sectors unless the other party grants MFN treatment on a reciprocal basis. See UNCTAD (2010), *Most Favoured Nation Treatment*, op. cit., at 49.

80 *Maffezini v. the Kingdom of Spain*, Decision on Jurisdiction of 25 January 2000 and Award of the Tribunal of 13 November 2000.

MFN clause in an IIA could use a more favourable procedure found in another IIA to which the host state was a party, rather than the specific dispute settlement procedure provided for in the treaty to which the investor's home state was a party. In *Maffezini*, an Argentine investor with a claim against Spain argued successfully that the investor–state arbitration procedures in the Spain–Chile BIT were more favourable than those in the Spain–Argentina BIT, because the Spain–Argentina BIT required an Argentine investor to wait 18 months before bringing a claim under the BIT, while the Spain–Chile BIT had no such requirement. The Argentine investor was allowed to proceed against Spain without meeting the 18-month requirement because it was entitled to MFN treatment under the Spain–Argentina BIT. Subsequent cases have come to differing conclusions in specific situations about the extent to which MFN provisions should be interpreted in this way.

There are a wide variety of ways in which an MFN might import treaty provisions. These are set out in Box 5.5. Some recent model treaties now have provisions that specifically address this problem.

Box 5.5 Possible application of an MFN provision to incorporate provisions from third party treaties into the basic treaty between two states – five cases

Five situations in which an MFN obligation in an IIA could conceivably incorporate provisions from another treaty are described below. In this discussion, 'basic treaty' is used to refer to the treaty between a host state and the state of an investor making a claim against the host state that has an MFN provision, while 'third party treaty' is used to refer to a treaty between the host state and another state.

1. The same categories of investor protection exist in both the basic treaty and a third party treaty, but a more favourable version of the standard for investor protection exists in the third party treaty than in the basic treaty.
2. A standard of investor protection in a third party treaty does not exist in the basic treaty (e.g. national treatment).
3. A provision related to the scope of the treaty in a third party treaty is broader than the comparable provision in the basic treaty (such as the definition of investor or the time period during which the treaty operates).
4. A provision restricting investor protection in the basic treaty does not exist in a third party treaty (such as an exception).
5. A procedural provision in the third party treaty establishes (i) requirements for the admissibility of investor–state claims (e.g. the expiry of an 18-month waiting period for claims to be brought) or (ii) requirements for an investor–state tribunal to have jurisdiction that are more favourable than the

(Continued)

(Continued)

comparable provision in the basic treaty (e.g. defining what may be the subject of dispute settlement under the IIA).[81]

The many investor–state arbitration cases that have dealt with these issues have been recently surveyed by UNCTAD.[82] While the case law is not consistent, and particular decisions are tied to the specific facts of the case, UNCTAD offered some rough generalisations regarding the cases to date:

- Tribunals have not reached consistent conclusions on whether a more favourable version of an investor protection provision in a third party treaty can be incorporated into the basic treaty to replace a less favourable provision (Case 1), though the weight of authority would suggest that this is the right approach.[83] If it could be established that the treatment under the third party treaty was better, the MFN obligation could probably be relied on to incorporate that version of the provision into the basic treaty.
- Tribunals have been willing to consider incorporating from third party treaties a substantive standard that is not present in the basic treaty (Case 2), but not provisions relating to the scope of the treaty (Case 3) that would have the effect of expanding the scope of application of the basic treaty.
- Tribunals have not been willing to eliminate restrictions on investor protection in the basic treaty on the basis that they do not exist in a third party treaty (Case 4).
- With respect to dispute settlement procedures (Case 5), a majority of cases have permitted the incorporation into the basic treaty of more generous requirements for admissibility, though there is substantial disagreement in the cases regarding the propriety of doing so. In contrast, most tribunals have rejected the incorporation of more generous jurisdictional requirements from a third party treaty to expand the scope of tribunal jurisdiction in the basic treaty.

Several important implications for states arise from the arbitral jurisprudence relating to the incorporation of rules in third party treaties into the basic treaties between party states under an MFN provision.

- Existing IIAs should be reviewed to determine to what extent MFN clauses in those treaties could
  - Incorporate more investor-friendly provisions in a state's other existing treaties, or
  - Incorporate new more investor-friendly commitments in treaties a state negotiates in the future.

81 These categories are borrowed from UNCTAD (2010), *Most Favoured Nation Treatment*, op. cit., at 58–84.

82 Ibid.

83 Dolzer and Schreuer, op. cit., at 190.

- As a result of such a review, it may be prudent to seek to renegotiate MFN provisions in existing treaties or to adopt bilaterally or unilaterally an interpretation of such provisions with a view to limiting the scope of these provisions to incorporate more investor-friendly provisions from third party treaties.[84] Alternatively, a state could seek to renegotiate provisions in existing treaties that it considered too investor-friendly with a view to limiting their application.
- In IIA negotiations, particular attention should be paid to
    - Identifying the extent to which proposed MFN obligations may incorporate more investor-friendly provisions from existing treaties and treaties negotiated in the future, and
    - Drafting MFN provisions in ways that will specifically avoid the unwanted (or unanticipated) incorporation of more investor-friendly obligations from other treaties.
- If, in a new IIA, an MFN provision is agreed to that does not contain an exception or other form of limitation on the incorporation of more investor-friendly provisions in other treaties, a party state should review its existing IIAs to determine to what extent provisions from other treaties could be incorporated into the new IIA.

IIA practice – limits on MFN

Several approaches to drafting MFN provisions have been adopted in IIAs that address the incorporation of treaty standards from third party treaties into basic treaties between two states. As noted, the model treaties of Canada and the USA limit the MFN obligation to specific kinds of activities in relation to an investment: 'the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments'. Since this language does not include dispute settlement, the limitation of MFN to these activities should have the effect of preventing the incorporation into a basic treaty of any rule regarding dispute settlement in a third party treaty.[85] Some treaties have gone farther and made an exclusion of such rules an explicit part of their understanding regarding what these limited activities include.[86]

In addition, there are certain kinds of exclusions from the MFN obligation that are commonly found in IIAs, such as exclusions for preferences granted in treaties to reduce the incidence of double taxation as well as free trade agreements, customs

84 Some treaties provide for binding interpretations by the parties (e.g. NAFTA (1992), Art. 1131). In any case, the *Vienna Convention on the Law of Treaties* establishes as a general rule of interpretation that any agreement between the parties regarding interpretation be taken into account (Arts. 31.3 and 31.4). See Section 7.1 (Investor–state dispute settlement) for a discussion of a mechanism for the adoption of interpretations by the party states.

85 This was the position taken by the negotiating parties to the Free Trade Agreement for the Americas in a footnote to the proposed MFN provision (cited in UNCTAD (2010), *Most Favoured Nation Treatment*, op. cit., at 85–6).

86 E.g. Canada–Peru FTA (2008), Annex 804.1; Colombian model agreement, Art. IV.2.

unions and other kind of bilateral or regional economic integration agreements.[87] Annex III to the Canadian model FIPA specifically excludes the application of MFN to other international agreements as well as to foreign aid programmes.[88]

Box 5.6 Summary of options for MFN treatment provision

1. *No MFN obligation;*
2. *A post-establishment MFN obligation that may be limited in one or all of these ways:*
   a. To specific activities (and *not* including activities such as establishment, acquisition and expansion);
   b. To foreign investors 'in like circumstances';
   c. To listed policy areas, sectors and measures (positive list) or excluding listed policy areas, sectors and measures (negative list);
   d. Subject to general exceptions; and
   e. To *de jure* discrimination
3. *A pre-establishment MFN obligation that may be limited in the same ways as discussed in option 2.*

5.4.5 Discussion of options

1. *No MFN obligation*

Most IIAs contain an MFN obligation. An MFN obligation provides protection against host state actions that treat investors from an IIA party state less favourably than investors from other states. With the exception of preferences resulting from investor protection and investor–state dispute settlement provisions in IIAs and preferences in some other international economic agreements, such discrimination tends to be less significant than discrimination against all foreigners, with the result that, practically, the MFN obligation may be considered both less important for investors and less burdensome for states. Nevertheless, in light of the uncertainty associated with the incorporation of other treaty provisions through an MFN provision, some states may decide not to include such an obligation.

It is possible that an IIA could contain an obligation to grant MFN treatment but only subject to the domestic law of the host state. In effect, this would not commit the host state to grant MFN treatment but only to ensure that any discrimination was authorised by law.

87 UNCTAD describes these as 'fairly standard' exclusions (UNCTAD (2010), *Most Favoured Nation Treatment*, op. cit., at 46). See for example, Indian model BIPPA, Art. 4(3); UK model IPPA, Art. 7; Colombian Model Agreement, Art. IV.3.

88 See Annex III to the Canadian model FIPA.

2. *A post-establishment MFN obligation that may be limited in one or all of these ways*

   a. Limited to specific activities (and *not* including activities such as establishment, acquisition and expansion)

This approach to drafting an IIA provision clarifies the scope of the obligation by limiting it to identified activities for the benefit of both investors and host states. The specification of activities to which the obligation applies may be interpreted as excluding the application of the MFN obligation to dispute settlement procedures in other IIAs. In the interests of clarity, recent IIAs often include a specific exception from the application of the MFN obligation to dispute settlement procedures in other IIAs. By excluding activities such as establishment, acquisition and expansion, this provision does not extend to pre-establishment activities.

   b. Limited to foreign investors 'in like circumstances'

A reference to 'in like circumstances' directs a tribunal to make sure that it considers a variety of factors to determine what foreign investors should be included in comparisons for the purposes of applying the MFN obligation. Some view the MFN obligation as inherently requiring such a determination, whether it refers to 'in like circumstances' or not. An express requirement to find that foreign investors are 'in like circumstances' provides clear direction to an interpreter of the provision. An analysis of 'in like circumstances' that takes into account the purpose of the measure may provide more scope for a state to engage in policies for non-discriminatory purposes that may have a discriminatory effect on foreign businesses from the other IIA party state. For the purposes of a particular policy, foreign investors from that state may not be in like circumstances with foreign investors from other states. An MFN obligation can provide more direction to an interpreter of the obligation by identifying possibly relevant circumstances that should be taken into account.

   c. Limited to listed policy areas, sectors and measures (positive list) or excluding listed sectors and measures (negative list)

Most IIAs exclude the application of the MFN obligation to some sectors or measures to reflect existing domestic policy that grants discriminatory preferences to foreigners and/or areas of policy where a state wants to be able to discriminate in the future between foreign investors. A negative list approach requires a state to list a sector or measure if the obligation is to be avoided. A positive list approach requires a state to list a sector or measure for the obligation to apply. Positive listing is a less burdensome approach because it is not necessary to list sectors or measures to avoid the application of the MFN obligation. With a positive list, however, remaining discriminatory restrictions are not disclosed to the other party state or its investors.

   d. Subject to general exceptions

Exceptions can be used to carve out areas of state policy-making from the application of the MFN obligation and are being increasingly used in IIA practice. Exceptions limit the benefits of the obligation for investors. In the case of MFN, IIAs often

contain exceptions that apply only to MFN obligations, in the interests of rendering the effect of the MFN provision more predictable. Two important and common categories of exceptions from MFN obligations are for commitments in preferential trading agreements and dispute resolution procedures in other IIAs.

e. Limiting MFN to *de jure* discrimination

The scope of an MFN obligation can be restricted to state measures that are *de jure* discriminatory. In other words, only measures that expressly discriminate against a foreign investor from one country compared with foreign investors from other countries based on the investor's nationality are prohibited. This approach creates a clear and predictable obligation, but one that is very limited in its scope. This approach is not currently followed in any IIA. Investors may be concerned that it is often difficult to distinguish between measures that are *de jure* and those that are only *de facto* discriminatory. Also, governments could draft measures that do not use language that is discriminatory, but then apply the measure in a discriminatory way. If an IIA prohibits only *de jure* discrimination, there would be no breach of the treaty in these circumstances.

3. *A pre-establishment MFN obligation that may be limited in the same ways as discussed in option 2*

A pre-establishment MFN obligation means that foreign investors must be treated no less favourably than other foreign businesses with respect to entry into the host state market. If specific activities to which the obligation applies are listed, they will include activities such as establishment, acquisition and expansion. Positive listing or negative listing can be used to ensure that the obligation does not apply to discriminatory entry restrictions for foreign investment that a state wants to maintain.

5.4.6 Discussion of sample provision

The Guide sample provision follows the approach in many IIAs and limits the application of the MFN obligation to situations in which foreign and domestic investors are 'in like circumstances'. This approach helps to ensure that investor–state tribunals engage in a serious investigation with a view to determining that the comparator used to define what MFN requires in relation to a foreign investor is a truly comparable foreign investor from another state. Such an approach may enhance regulatory flexibility compared with the unqualified formulations of the MFN obligation in some other national models. As with the national treatment provision, a list of factors to be taken into account in determining whether investors or their investments are 'in like circumstances' is set out in the sample provision with a view to helping to define more clearly when different treatment is permitted. For further certainty, the sample provision expressly states that a state measure that treats investors of the other party or their investments less favourably than investors of another state or their investments is not inconsistent with the MFN obligation if it is applied by the state in pursuit of a legitimate public purpose not based on the nationality of the investor and bears a reasonable connection to the purpose.

In addition, like most IIA provisions, the sample provision is limited to certain identified situations with a view to clarifying the scope of the obligation.[89] Consistent with widespread practice, a right of establishment is not provided for in the sample provision. The references to 'establishment', 'acquisition' and 'expansion' in the list of activities to which the obligation applies, found in the Canadian and US models, have not been included.[90] Limiting the scope of application of the MFN clause to certain situations should also eliminate the risk that dispute settlement provisions in other agreements could be accessed through the MFN clause by investors from states not party to those agreements, as in *Maffezini*.[91] It seems likely that the importation of investor–state dispute settlement procedures, and even other substantive treaty standards, was not foreseen, at least in treaties negotiated prior to *Maffezini* and the other cases that address this issue. In the interests of greater certainty, the sample provision in the Guide creates a number of specific exceptions to the MFN obligation as discussed below:

- **All international agreements existing at the time the IIA comes into force**: As an alternative, it would be possible to exclude only existing bilateral and regional agreements that require party states to accord preferences to investors from other parties based on their nationality, which would include not only investment agreements and free trade agreements, but also double taxation agreements and other forms of economic co-operation and economic partnership treaties. This is the approach adopted in the COMESA Investment Agreement.[92] It would also be possible to create a more limited exclusion that applied only to agreements creating such preferences that a party state listed as exceptions to the MFN obligation. This would be a more transparent approach to reconciling these kinds of preferences with the MFN obligation in an IIA. However, such an approach would be more burdensome. A straightforward exception for all existing agreements was adopted as an example of a provision that provides administrative simplicity and a high level of certainty for host states regarding the scope of the obligation.
- **Defined categories of future international agreements that create preferences based on nationality**: The categories exempted are those found in most IIAs: agreements (i) establishing, strengthening or expanding a free trade area, customs union, common market, labour market integration commitment or similar international agreement; (ii) promoting investment; or (iii) relating wholly or mainly to taxation.

89 E.g. the Canadian and US model agreements (Canadian model FIPA, Art. 4; US model BIT, Art. 4). See, similarly, the draft Norwegian APPI (Art. 4) and others.

90 Expansion includes an investment of new foreign capital to expand an existing business carried on by an investor. Similarly acquisition includes acquisitions financed by new foreign capital. However, an expansion or acquisition would also include transactions or activities financed in the host state. If an IIA contains a clear admission clause that ensures that any new investment must meet domestic requirements for admission, then expansion and acquisition could be included in the list of activities to which the obligation applies without creating a right of establishment.

91 *Maffezini v Spain*, op. cit.

92 COMESA Investment Agreement (2007), Arts. 19.1 and 19.3.

- **Any dispute settlement procedures in any other international agreement**.
- **Other agreements**: The sample provision contemplates that states may identify their own categories of future agreements in addition to those that are listed in the Guide provision that would be excepted from the MFN obligation.

Limiting the scope of the MFN obligation in all these ways prevents the importation of standards into a treaty relationship where those standards go beyond what the parties intended. Inevitably, this approach is imperfect. When negotiating new agreements, states will have to bear in mind the requirements of these limited exceptions for future agreements. If any commitments undertaken in future agreements do not fall within the exceptions, they may have to be extended to investors from a party state to those earlier IIAs through the operation of the MFN clause. Alternatives would include: (i) exempting *all* future preferential agreements that a party state might enter into; or (ii) not including an MFN obligation at all. Of course carving more future agreements out of the MFN obligation will reduce its value to investors. Not including an MFN obligation in an IIA means that foreign investors get no protection against domestic measures preferring foreign investors from other states and further reduces the value of the agreement to investors. The approach taken in the Guide provision represents a compromise, providing limited benefits for investors in terms of the future international commitments of a host state but full protection in relation to domestic measures. Limiting MFN in the ways described is unlikely to be perceived as affecting significantly the interests of investors, since they do not affect the basic non-discrimination obligation with respect to state domestic measures.

Finally, as with the national treatment obligation, the Guide includes sample provisions that provide for exceptions and country-specific reservations applicable to the MFN obligations.[93] Examples include public procurement and subsidies. As discussed, an alternative would be to have the MFN obligation apply only to sectors and measures that a state positively agrees to list. This option is provided for in brackets in the sample provision.

5.4.7 Sample provision: most favoured nation treatment

Most Favoured Nation Treatment

1. Every Party shall accord to investors of the other Party and their investments treatment no less favourable than that it accords, in like circumstances, to investors of any other state or to their investments with respect to the management, conduct, operation and sale or other disposition of investments in its territory.

2. For greater certainty:

    a. A determination of whether an investment or an investor are in like circumstances for the purposes of this article shall be made based on an assessment of all of the circumstances related to the investor or the investment, including:

        i. The effect of the investment on

93 See Section 5.12 (Reservations and exceptions).

A. the community;

B. the human rights of individuals and the rights of indigenous peoples;

C. the environment, including effects relating to the cumulative impact of all investments within a jurisdiction;

ii. The business sector in which the investor operates;

iii. The goal of the alleged discriminatory measure; and

iv. The regulation that applies to the investment or investor;

b. A measure of a Party that treats investors of the other Party or their investments less favourably than investors of another state or their investments is not inconsistent with this article if it is applied by the Party in pursuit of a legitimate public purpose that is not based on the nationality of investors, including the protection of health, safety and the environment, internationally and domestically recognised human rights, labour rights or the rights of indigenous peoples, or the elimination of bribery and corruption, and it bears a reasonable relationship to the purpose.

3. This article shall not apply to:

a. Treatment by a Party under any bilateral or multilateral international agreement in force or signed by the Party prior to the date of entry into force of this Agreement;

b. Treatment by a Party pursuant to any future bilateral or multilateral agreement:

i. Establishing, strengthening or expanding a free trade area, customs union, common market, labour market integration commitment or similar international agreement;

ii. Promoting investment; or

iii. Relating wholly or mainly to taxation or …;[94] or

iv. Any dispute settlement procedures.

[4. This article shall apply only to measures that a Party adopts or maintains with respect to sectors, subsectors or activities, as set out in its schedule to Annex 1 of this agreement.]

94 Each country should consider what specific categories of agreements should be listed based on its existing and anticipated future international commitments. Agreements may relate, for example, to aviation, fisheries or maritime transport, including salvage. These are areas where access is frequently granted to investors from particular states on the basis of reciprocal access from the other party state. (See Canadian model FIPA, Annex III).

5.5 Fair and equitable treatment and the minimum standard of treatment

Cross references

Section 4.2.1 The role of preambles in IIAs 42
Section 4.4 Statement of objectives 92
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5.5.1 Introduction

Most IIAs require party states to provide a minimum standard of treatment to the investments of investors of the other party state, which is described using the words 'fair and equitable treatment' (FET).[95] The general purpose of requiring fair and equitable treatment of investments is to protect investors against serious abuse and arbitrary or discriminatory actions by host states by requiring a standard of fair treatment. Unlike the national treatment and MFN standards, the FET standard is not a relative one. This means that regardless of how a state treats its own nationals and their investments, treatment of foreign investors and their investments cannot fall below the minimum standard defined in the treaty.

FET provisions have been the IIA provisions most frequently relied on by investors in investor–state arbitration claims and have resulted in the most successful claims. This is not surprising. The standard is inherently broad and open-ended. There are, potentially, an unlimited number of situations in which investors may claim that their investments have been treated by a host state in a manner that is not fair and equitable. In addition, investors have been encouraged to make claims based on FET because investor–state arbitration tribunals have interpreted the FET standard in a wide variety of ways, sometimes leading to surprising results. A number of commentators have expressed concerns that the FET standard as it has been applied creates a significant risk that it will be used to constrain a state's sovereignty and its ability to regulate in the public interest.[96]

As discussed below, there is now a well-developed debate about the content of the FET standard, but little certainty regarding what this obligation requires of states in particular circumstances.[97] The uncertainty of the standard makes it challenging for states to implement the FET obligation with confidence and encourages 'regulatory chill' – states concerned about complying with their obligations and managing the risk of investor–state claims may try to avoid any action that even might be a breach of the standard.

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95 For example, the Indian model BIPPA, Art. 3(2) simply refers to fair and equitable treatment.

96 R Kläger (2011), 'Fair and Equitable Treatment and Sustainable Development', in Cordonier Segger et al., op. cit., at 241; G Mayeda (2007), 'Playing Fair: The Meaning of Fair and Equitable Treatment in Bilateral Investment Treaties (BITs)', 41 *Journal of World Trade* 273.

97 Ibid.

The essential problem is that the FET standard has no definable specific meaning.[98] This has made it useful as a gap-filling device because not all kinds of state misbehaviour can be caught by the more specific investor protection standards in IIAs, but has also rendered its application unpredictable. IIAs provide little guidance to tribunals regarding the interpretation of the standard, though statements regarding the purpose and priorities of the party states in IIA preambles and objectives provisions may be helpful in particular cases. The lack of predictability is aggravated by the fact that prior decisions in investor–state cases do not constitute binding precedents for subsequent decisions.

The discussion below surveys existing state practice regarding FET provisions in IIAs and identifies the main considerations regarding their application.

5.5.2 IIA practice

While almost all IIAs have some kind of FET provision, the expression of the standard varies considerably.[99] For states that have signed multiple IIAs with different versions of the FET obligation this diversity makes it difficult for them to keep track of their obligations.[100] Some treaties simply require party states to provide fair and equitable treatment.[101] Others combine an FET standard with additional treaty requirements for 'full protection and security', and obligations not to discriminate against or act unreasonably in relation to foreign investments.[102]

As will be discussed below, one of the difficult issues with respect to FET is to what extent it represents an expression of the minimum standard of treatment required of host states under customary international law as opposed to an autonomous treaty standard. How FET is characterised in this regard can have an impact on the content of the obligations. There are variations in treaty provisions in terms of how they describe the relationship between FET and international law. Some treaties require that fair and equitable treatment be provided 'in accordance with international law', suggesting that the standard is to be defined by reference to international law, including customary law, general principles of international law and other sources of international law. For example, NAFTA requires 'treatment in accordance with

98 UNCTAD (2012), *A Review of Fair and Equitable Treatment: A Sequel*, United Nations, New York and Geneva, at 2–3.

99 Not all agreements, however, contain such an obligation (e.g. India–Singapore CECA (2005); Australia–Singapore Free Trade Agreement, signed 17 February 2003, in force 28 July 2003; and the AALCC model agreements, though the inclusion of an FET obligation was suggested by Kuwait). Whether the minimum standard required by customary international law can be enforced through investor–state arbitration under an IIA with no FET obligation depends on the scope of the dispute settlement procedures. If the procedures are available only for breaches to the treaty then they cannot be used in this way, unless FET can be incorporated into the agreement through an MFN provision.

100 This kind of problem can be complicated by the presence of MFN provisions that may be argued to import the higher FET standard agreed to by a state into another treaty, as discussed in the previous section. See Article Section 5.4 (Most favoured nation).

101 Indian model BIPPA, Art. 3(2) simply refers to 'fair and equitable treatment'.

102 UK model IPPA, Art. 2, contains all of these obligations.

international law, including fair and equitable treatment and full protection and security'.[103] Other treaties tie FET only to the minimum standard imposed on host states by customary international law. The Canadian model treaty, for example, seeks to limit the scope of application of FET by defining the standard as 'treatment in accordance with the customary international law minimum standard of treatment of aliens, including fair and equitable treatment and full protection and security'.[104] The Canadian provision goes on to specify that fair and equitable treatment and full protection and security do not require treatment 'in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens'.[105] In 2001, the NAFTA Free Trade Commission issued a binding interpretation saying that the FET standard in that treaty means the customary international law standard for the treatment of aliens.[106]

More recent treaties have started to include additional language clarifying the meaning of the obligation in specific ways. The US model BIT specifies that the FET obligation includes a commitment:

> … not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world.[107]

Additional specific treaty stipulations regarding the content of the standard include prohibitions on arbitrary, unreasonable or discriminatory measures.

Some treaties provide that breaches of other treaty rights do not result in a breach of the minimum standard of treatment. This clarifies the scope of the provision and avoids the application of some investor–state dispute settlement cases that have ruled the opposite.[108]

The COMESA Investment Agreement adopts a different approach. It expresses member states' understanding that the international minimum standard is not a single standard, that different states have different forms of administrative, legislative and

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103 NAFTA (1992), Art. 1105.

104 Canadian model FIPA, Art. 5. The Norwegian Draft model APPI uses the same wording (Art. 5). See also the ASEAN–Australia–New Zealand FTA (2009), Chapter 11, Art. 6.

105 Ibid. COMESA Investment Agreement (2007) (Art. 14) and the US model BIT (Art. 5(2)) contain similar language.

106 NAFTA Free Trade Commission Notes of Interpretation, 31 July 2001.

107 US model BIT, Art. 5; and see COMESA Investment Agreement (2007), Art. 14. The ASEAN Agreement (Art. 11) specifies that FET 'requires' parties not to deny justice. The IISD model treaty is very similar (Art. 8). In some treaty models, these additional standards are referred to separately without being tied to FET.

108 This second type of specification appeared in provisions negotiated after the NAFTA (1992) decision in *S D Myers v. Canada*, op. cit., para. 261, which held that a breach of national treatment was a breach of NAFTA's FET standard. This conclusion was effectively reversed by the FTC Notes on Interpretation, 2001. As a general rule, the amount of compensation will not be different regardless of whether the conduct concerned is held in breach of one or two IIA obligations.

judicial systems, and that member states at different levels of development may not all achieve the same standards at the same time.[109]

As noted, the requirement that the host state provide 'full protection and security' to investments of foreign investors is often included in provisions relating to fair and equitable treatment, though it sometimes appears as a stand-alone obligation in an IIA.[110] The duty to provide full protection and security is generally understood to require the host state to take active steps, such as through police protection, to protect a foreign investor's investment from injury – traditionally understood as physical injury – resulting from civil unrest or local violence. It does not constitute an absolute commitment to protect in all circumstances. The state's obligation has been characterised as an obligation to take such steps as may be reasonable in the circumstances.[111] Some tribunals have extended its application to the protection of the security of legal rights and economic interests. In effect, this approach treats full protection and security as a part of FET.

5.5.3 Minimum standard of treatment required by customary international law versus an autonomous treaty standard[112]

Where treaties have referred simply to 'fair and equitable treatment,' the obligation on states has often been given a broader interpretation than treaty standards that are tied to the international minimum standard required by customary international law, though the content of both obligations is contested.[113] The purpose of tying FET to customary international law in IIAs is to try to ensure that FET is not interpreted as an autonomous treaty standard and to avoid overly broad interpretations of the provision. Part of the rationale for this approach is that customary international law standards must be demonstrated through state behaviour arising out of a sense of legal obligation, which must be objectively determined. If 'fair and equitable treatment' is not restricted to the customary international law standard, however, this standard could be understood as an open-ended and unpredictable requirement for a state to act fairly, leaving it to an investor–state arbitration tribunal to determine what is fair in particular circumstances. Some tribunals have followed such an approach, though a few have suggested that a state's misconduct must meet a minimum threshold of seriousness before a breach will be found.[114] Under this approach, not every case of unfairness will justify a finding of state liability.

Unfortunately, the content of the minimum standard itself is not well developed and the approach of arbitral tribunals has not been consistent, leaving significant residual uncertainty. The development of the customary international law standard and its recent application are described in the next section.

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109 COMESA Investment Agreement (2007), Art. 14.3.

110 This language is typical of Caribbean BITs and found in all Pacific BITs (Malik, op. cit., at 17, 50).

111 Dolzer and Schreuer, op. cit., at 149–150, describing the obligation as one to provide due diligence.

112 Customary international law results from a general and consistent practice of states that they follow from a sense of legal obligation.

113 Most Caribbean BITs and all Pacific BITs use this language (Malik, op. cit., at 16, 49). This language is also used in the ASEAN Agreement (2009), Art. 11.

114 Malik, ibid., at 88.

5.5.4 Evolution of the customary international law minimum standard

Historically, the source of the FET standard is the customary international law minimum standard of treatment.[115] Some developing countries have traditionally denied the existence of an international minimum standard. They have argued that state sovereignty permits national governments to set the standard of fairness applicable to foreign nationals and their investments.[116] Numerous investor–state tribunals, however, have found that a minimum standard is required by customary law.

International arbitration tribunals have differed, however, in their interpretation of what the minimum standard requires. In contemporary investor–state arbitration, particularly in NAFTA cases, the starting point for defining the requirements of FET is often a famous case called *The Neer Claim* decided in 1926.[117] The case deals with whether Mexico failed to take adequate steps to investigate and prosecute the murderer of an American, resulting in a denial of justice.[118] The tribunal found that customary international law prohibits egregious or outrageous behaviour by a state towards a foreign citizen.

> [T]he treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.[119]

While this standard clearly sets a high threshold for challenging state action, its content is indeterminate. Since *Neer* addressed only the denial of justice in relation to individual aliens, it has not been clear what it requires in relation to foreign investors and their investments. Another significant question is to what extent the standard has evolved since the *Neer* decision.

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115 Ibid., at 5.

116 Historically, developing countries, particularly in Latin America, have supported the *Calvo Doctrine*, which asserts the sovereignty of developing countries and their freedom from interference by other states, as well as the principle that foreign nationals ought not to be given treatment to which nationals are not entitled (D Shea, *The Calvo Clause: A Problem of Inter-American and International Law and Diplomacy* (1955), University of Minnesota Press, Minneapolis, at 19–20). Proponents of the doctrine oppose the development of minimum standards of treatment for foreign nationals in customary international law, since these standards do not respect the exclusive jurisdiction of the host country. See also D Manning-Cabrol (1995), 'The Imminent Death of the Calvo Clause and the Rebirth of the Calvo Principle: Equality of Foreign and National Investors', 26 *Law and Policy in International Business*, 1169; B Tamanaha (1995), 'The Lessons of Law and Development Studies', 89 *American Journal of International Law*, 470 at 478; T Guha Roy (1961), 'Is the Law of Responsibility of States for Injuries to Aliens a Part of Universal International Law?', 55 *American Journal of International Law* 863.

117 Some researchers argue that *Neer* does not represent an accurate statement of customary law: e.g. J Thornton (2012), 'Divining the Content of the Customary International Law Minimum Standard Treatment from the Jurisprudence of the US–Mexico General Claims Commission', *World Arbitration and Mediation Review* (forthcoming).

118 *Neer v. Mexico, Opinion*, United States–Mexico General Claims Commission, 15 October 1926, (1927), 21 *American Journal of International Law* 555.

119 Ibid.

In a 2009 NAFTA case, the tribunal held that the investor had not succeeded in proving that the standard had evolved beyond what it had been found to require in *Neer*. The tribunal described the standard in the following terms:

> The Tribunal therefore holds that a violation of the customary international law minimum standard of treatment, as codified in Article 1105 of the NAFTA, requires an act that is sufficiently egregious and shocking – a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons – so as to fall below accepted international standards and constitute a breach of Article 1105. Such a breach may be exhibited by a 'gross denial of justice or manifest arbitrariness falling below acceptable international standards'; or the creation by the State of objective expectations *in order to induce* investment and the subsequent repudiation of those expectations. (References omitted.)[120]

A number of investor–state cases under NAFTA have agreed that a state action must be shocking or serious to breach the standard, as this quote suggests.[121] NAFTA tribunals have acknowledged that what is considered shocking or serious is likely to have evolved over time,[122] but the exact nature of the evolution is not clear. In addition, arbitral tribunals have confirmed that it is possible that the customary standard in *Neer* has changed through consistent state practice engaged in out of a sense of legal obligation. However, it has proved difficult for investors to successfully show that the standard has changed over time or that it imposes specific requirements.[123] In this regard, tribunals have not been consistent regarding what is needed to prove an evolution in customary law. Some tribunals have decided that arbitral tribunal decisions do not create or prove customary international law, though they may be looked at as illustrations of customary law if they are interpreting the customary international law minimum standard and not an autonomous FET standard.[124] Others have looked to the practice of states in signing IIAs with FET provisions as evidence of an evolving standard, but have not identified specifically what it requires.[125]

In 2010, a NAFTA tribunal determined that the autonomous standard has become part of customary law based on what it described as widespread and consistent practice.[126] Unfortunately, this award failed to explain the basis for its conclusions that the minimum standard has evolved in this way.[127] Recently, UNCTAD has

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120 *Glamis Gold, Ltd. v. United States of America*, UNCITRAL, Award, 8 June 2009, at para. 627.

121 Some tribunals have adopted an apparently lower threshold. In *Waste Management*, for example, the tribunal synthesised the standard as prohibiting state behaviour that is 'arbitrary, grossly unfair, unjust or idiosyncratic' or that is 'discriminatory and exposes the claimant to sectional or racial prejudice' (*Waste Management v. Mexico*, op. cit., at para. 98).

122 *Mondev International Ltd v. United States*, ICSID Case No. ARB (AF)/99/2, Award, 11 October 2002.

123 *Glamis Gold*, op. cit., at para. 614, referring to other NAFTA awards.

124 *Glamis Gold*, ibid., at para. 605.

125 *Mondev*, op. cit., at paras. 114–19.

126 *Merrill and Ring v. Canada*, UNCITRAL, Award 31 March 2010. See also *Waste Management v. Mexico*, op. cit., at para. 98.

127 UNCTAD (2012), *Fair and Equitable Treatment*, op. cit., at 57.

suggested that there is evidence of a long-term trend in the cases towards *de facto* convergence in terms of the categories of state behaviour that may raise concerns under FET.[128] A remaining difference seems to be that a higher threshold for the seriousness of state conduct must be established if an FET standard is limited to the minimum standard of treatment under customary international law. Investors making claims under NAFTA, where the FET obligation is limited to the minimum standard in customary international law, have been less successful than investors seeking relief under other treaty standards on the basis of a breach of FET.[129] There is no guarantee, however, that a higher threshold for finding a breach of state action will be adopted in interpreting an FET obligation tied to customary law.

5.5.5 What the FET standard requires

General requirements

In terms of its specific content, the following synthesis of the categories of requirements imposed by FET was recently provided by UNCTAD:

a. Prohibition of manifest arbitrariness in decision-making, that is measures taken purely on the basis of prejudice or bias without a legitimate purpose or rational explanation;

b. Prohibition of the denial of justice and disregard of the fundamental principles of due process;

c. Prohibition of targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief;

d. Prohibition of abusive treatment of investors, including coercion, duress and harassment;

e. Protection of the legitimate expectations of investors arising from a government's specific representations or investment-inducing measures, although balanced with the host State's right to regulate in the public interest.[130]

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128 UNCTAD (2012), *Fair and Equitable Treatment*, ibid., at 59–60.

129 Ibid., at 60–1.

130 Ibid., at 62–3. The OECD takes the view that the fair and equitable treatment standard goes beyond customary international law to impose the following additional requirements:

1. An obligation of vigilance and protection (i.e. an obligation to exercise due diligence in protecting foreign investments);
2. An obligation of transparency in the treatment of foreign investors;
3. An obligation of good faith, which includes an obligation to protect the basic expectations of investors created by the treaty;
4. An obligation to respect 'autonomous fairness elements', which seems to include fairness obligations beyond those required by international law and that are generally recognised in the legal systems of states with well-developed legal systems.

(OECD (September 2004), 'Fair and Equitable Treatment Standard in International Investment Law', Working Papers on International Investment No. 2004/3 at 26–39).

Protection of legitimate expectations

It is the obligation to protect the legitimate expectations of investors that has the greatest potential to cause difficulty for host developing countries. The concept of legitimate expectations is complex and has not been treated in a uniform way by investor–state tribunals. The key elements of the approaches taken to determining what are an investor's legitimate expectations are identified below:

- **Legitimate expectations of investors require host states to provide a stable and predictable investment environment:** Some investment tribunals have interpreted this aspect of the FET obligation broadly as requiring the host state to ensure that the conditions that induced the investor to invest are not to be disturbed.[131] Such a wide interpretation of the principle of fair and equitable treatment provides tribunals with substantial scope to grant relief whenever the legal and regulatory frameworks of a host state are changed. Some tribunals have expressly determined that a breach of legitimate expectations may occur in these circumstances, even if the state is acting in the good faith pursuit of a legitimate regulatory goal.[132] Such a broad approach to protection has been criticised as unreasonable on the basis that it prevents any regulatory reform.[133]
- **Legitimate expectations must include an expectation of the risk of regulatory change over time:** In response to the concerns noted in the previous point, some tribunals have recognised that while investors may generally expect a stable and predictable regulatory regime, especially the maintenance of the conditions upon which they based their initial decisions to invest, regulatory change is to be expected over time and this consideration should inform what is a legitimate expectation of investors.[134] More generally, in some cases tribunals have said that in identifying an investor's legitimate expectations, it is necessary to take into account the facts relating to the investment as well as 'the political, socioeconomic, cultural and historical conditions prevailing in the host state'. In *Vivendi II*, for example, it was recognised that a newly elected government that advocated different policies from its predecessors should be permitted to adopt a different approach to regulation.[135] In order to achieve its regulatory objective, however, a state must act in a manner otherwise consistent with all IIA obligations, including the other requirements of FET. In *Vivendi II*, the new government's change in policy affected a contract that the investor had entered into. The tribunal suggested that the state should

131 *CMS Gas*, op. cit.; *Tecnicas Medioambientales Tecmed S.A. v. Estados Unidos Mexicanos*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, at para. 154; *CME Czech Republic B.V. v. The Czech Republic*, UNCITRAL, Award, 14 March 2003, at para. 601; *Occidental Exploration and Production Company v. Republic of Ecuador*, Case No. UN 3467, Final Award, 1 July 2004, at para. 190.

132 *Enron v. Argentina*, op. cit., at paras. 164–168. This part of the decision was upheld by an annulment panel: *Enron v. Argentina*, Decision on the Application for Annulment, 30 July 2010, at paras. 298–316.

133 This approach was suggested in UNCTAD (2012), *Fair and Equitable Treatment*, op. cit.

134 E.g. *Saluka v. Czech Republic* UNCITRAL, Partial Award, 17 March 2006, at paras. 304–8; *Glamis Gold*, op. cit.

135 *Suez, Sociedad General de Aguas de Barcelona SA and Vivendi Universal SA v. Argentine Republic*, (2003) ICSID Case No. ARB/03/19, Decision on Liability, 30 July 2010 (called Vivendi II), at para. 7.4.31.

be able to seek to renegotiate the contract, but that the renegotiations should be transparent and non-coercive. They should not be accompanied by 'threats of rescission' based on unfounded allegations.

- **Legitimate expectations must take into account the level of development of the host state:** What an investor may legitimately expect from a developing country and its institutions cannot be the same as it would expect from a developed country.[136] This is really only a specific example of the approach mentioned in the previous point.
- **Legitimate expectations may be produced by specific acts of the host state in relation to the investor:** Specific representations by host country officials and contractual commitments are generally accepted as providing a basis for legitimate expectations.[137] With respect to contractual commitments, contractual performance may be a reasonable expectation, but not all breaches of contract should be treated as breaches of FET.[138]
- **An investor's behaviour may be relevant to determining the investor's legitimate expectations:** With regard to defining an investor's legitimate expectations, the investor's own behaviour will be relevant in some circumstances. For example, if the investor has engaged in fraud or misrepresentation, or otherwise acted so as to cause the state to act, it will be more difficult for the investor to establish that the state's action was inconsistent with its expectations.[139] In addition, the investor must have relied on what are alleged to be its legitimate expectations in making the investment in order to succeed in claiming a breach of FET on this basis.[140] Some tribunals have taken a different approach to this issue. Where a breach of FET is found, they have taken into account the behaviour of the investor and the interests of the state in assessing the damages to be paid to the investor. Tribunals have required investors to have carried out due diligence investigations to inform their expectations and where an investor has not acted reasonably in this regard, the tribunal has reduced the damages awarded to the investor.[141]

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136 *Genin v. Estonia*, ICSID Case No. ARB/99/2, Award, 25 June 2001, at para. 367; *Parkerings-Compagniet v. Lithuania*, ICSID Case No. ARB/05/8, Award, 11 September 2007, at para. 344. It is not clear to what extent this is conceptually consistent where the standard is equated to the customary international law minimum standard which is intended to create a floor below which no state may go (UNCTAD (2012), *Fair and Equitable Treatment*, op. cit., at 34–5).

137 Ibid.

138 C Schreuer (2007), 'Fair and Equitable Treatment: Interactions with Other Standards', 4 *Transnational Dispute Management* 17.

139 For example, in *EDF v. Romania*, ICSID Case No. ARB/05/13, Award, 8 October 2009, the tribunal determined that Romania's prohibition of duty-free businesses at domestic airports was held to be a reasonable response to contraband activities being carried out by those businesses.

140 *Duke Energy v. Ecuador*, ICSID Case No. ARB/04/19, Award, 18 August 2008, at para. 340.

141 *MTD v. Chile*, ICSID Case No. ARB/01/07, Award, 25 May 2004: damages reduced by 50 per cent where an independent assessment would have revealed that the authorisation received was not permitted by local law.

- **An investor's legitimate expectations must be weighed against host states' legitimate interest in regulating for the public good:** A number of tribunals have recognised that in determining whether there has been a breach of FET, it is necessary to weigh whatever legitimate expectations an investor is found to have with the interest of the state in regulating. This does not mean that states may act however they choose to achieve their regulatory objectives. A state must act in a good faith and in a manner otherwise consistent with all IIA obligations, including the other requirements of FET.[142]

Box 5.7 Options for a fair and equitable treatment provision

1. *No FET obligation;*
2. *FET obligation linked to the minimum standard of treatment of aliens under customary international law;*
3. *FET obligation linked to international law;*
4. *Unqualified FET obligation to accord fair and equitable treatment (the autonomous standard);*
5. *FET obligation (whether or not linked to international law or the minimum standard of treatment of aliens under customary international law) with additional substantive content, such as a prohibition on denial of justice or treatment of investor and its investments that is manifestly arbitrary, discriminatory or abusive, to clarify its meaning;* and
6. *No FET obligation but specification of prohibited state actions as in option 5.*

5.5.6 Discussion of options

1. *No FET obligation*

The minimum standard of treatment under customary international law would still apply even if no FET obligation were included in a treaty. Probably this standard could not be enforced through investor–state arbitration under an IIA, though this would depend on the scope of the dispute settlement provisions in the IIA. Not including an FET obligation would be inconsistent with the dominant IIA practice and would undoubtedly be a concern for capital-exporting states. Nevertheless, in light of its unpredictability, some capital-importing states may seek to exclude it.

If an IIA contains no FET obligation, but (i) the IIA contains an MFN obligation; and (ii) the state party had entered into another IIA that contained an FET provision,

142 *Saluka v. Czech Republic*, op. cit., at paras. 304–8.

it is possible that the FET obligation would be incorporated into the treaty through the MFN obligation.

2. *FET obligation linked to the minimum standard of treatment of aliens under customary international law*

This is an approach intended to limit the scope of the FET obligation. In principle, an investor would have to prove what the standard required based on general and consistent state practice of states motivated by a sense of legal obligation, though tribunals have not always strictly adhered to these requirements. There is also uncertainty regarding what the standard requires. Some tribunals have determined that the categories of state action that can be addressed under the minimum standard of treatment are converging with those that can be addressed under an autonomous FET standard (option 4). The liability threshold may be higher under the customary international law standard, though this is not clear. Nevertheless, many IIAs, including the US and Canadian model agreements, adopt this approach with a view to limiting the scope of the obligation.

3. *FET obligation linked to international law*

The standard must be determined by reference to all sources of international law. Some IIAs adopt this approach. It is not clear how this standard is different in practice from option 2. A link to customary international law is more specific.

4. *Unqualified FET obligation to accord fair and equitable treatment (the autonomous standard)*

This obligation provides maximum assurance to investors, but allows for far-reaching review of host state actions by investor–state arbitration tribunals based on an uncertain standard of fairness.

5. *FET obligation (whether or not linked to international law or the minimum standard of treatment of aliens under customary international law) with additional substantive content, such as a prohibition on denial of justice or treatment of investor and its investments that is manifestly arbitrary, discriminatory or abusive, to clarify its meaning*

It is not clear how this standard is different in practice from options 2, 3 and 4. Most of the additional language used in treaties has described elements that tribunals have found to be part of the FET standard in any case. FET could be defined as including only those standards identified. This would clarify the scope of the obligation.

6. *No FET obligation, but specification of specific prohibited state actions as in option 5*

The scope of this obligation depends on the language used. It avoids the risk of an open-ended FET standard, but the terms used instead may introduce new uncertainty. Most of the language used to specify what is prohibited refers to aspects of what tribunals have found to be part of the FET standard such as a prohibition on denial of justice or treatment of investor and its investments that is manifestly arbitrary, discriminatory or abusive.

With respect to options 2, 3, 5 and 6, if (i) a state has imposed limitations on the scope of the FET obligation in an IIA, (ii) the IIA contains an MFN obligation and (iii) the state has entered into another IIA that contains an FET provision without these limitations, it is possible that the more favourable FET obligation will be incorporated into the treaty.[143]

5.5.7 Discussion of sample provision

The FET standard has been the subject of a large number of arbitral decisions that have not produced a consistent approach to interpretation – or consistent results. Some decisions have been criticised as imposing inappropriate constraints on state regulatory power. In this context, states may decide that the best course of action is not to agree to an FET provision at all. On the other hand, capital-exporting states and their investors may prefer a simple statement of FET as an autonomous standard to provide the broadest protection.

The Guide sample provision sets out an example of how an FET provision can be made somewhat more certain than existing provisions. In general this has been done by making explicit some of the limitations on the standard developed in the arbitral cases. It must be acknowledged, however, that significant residual uncertainty remains about how the provision will be applied in particular circumstances. As an alternative, a state may seek to include specific commitments without referring to the minimum standard of treatment or FET. While this approach avoids the uncertainty associated with the FET standard, referring to new treaty standards such as a prohibition on denial of justice or manifestly arbitrary treatment raises new issues of interpretation and uncertainty. The approach adopted in the sample provision may be summarised as follows:

- **FET tied to minimum standard established by customary international law:** As is common in many IIAs, the sample provision specifies that foreign investors can expect to be treated in accordance with the international minimum standard established by customary international law for the treatment of foreign nationals. This language follows the Canadian and US models among others. This has been achieved by referring to the standards of fair and equitable treatment and full protection and security, but qualifying these standards as equivalent to and subsumed within the minimum customary international law standard.

  By specifying that the content of these standards does not go beyond the minimum standard of treatment required by customary international law, the Guide provision seeks to restrict the ability of international tribunals to conduct a wide-ranging review of the legislative, regulatory and policy decisions of the host state based on what they think is fair. In the formulation adopted in the Guide, the standard that tribunals apply must be determined by reference to what customary international law requires. In principle, proof of customary international law requires consistent generalised state practice that is engaged in out of a sense of

143 This was done in *Bayindir v. Pakistan*, ICSID Case No. ARB/03/29, Award, 27 August 2009.

legal obligation. It must be admitted that tribunals have not been consistently rigorous in demanding proof of customary law in practice and have differed in what customary law requires. Also, the very existence of a customary standard is disputed by some countries. Consequently, tying the FET standard to customary international law leaves significant residual uncertainty.

- **FET limited to specific kinds of state actions:** The sample provision identifies state measures that are manifestly arbitrary, unreasonable or discriminatory, or that are a gross denial of justice and due process, as the exclusive content of the prohibition in the FET obligation. In effect, the enumeration of these standards incorporates the high threshold for finding that a state has breached the FET obligation that has been established in arbitration cases under NAFTA. It also reflects the categories of state action that have been identified in other treaties as examples of what FET requires.[144] No treaty to date has limited the categories of FET in this way.
- **Breach of another provision of the IIA does not mean that there is a breach of FET:** Section 3 of the Guide sample provision provides that breaches of other treaty rights do not result in a breach of the minimum standard of treatment, following the Canadian and US models among others. This clarifies the scope of the provision and avoids the application of some investor–state dispute settlement cases that have ruled that a breach of another IIA obligation is a breach of FET.
- **Level of development of host state to be taken into account:** Following the COMESA Investment Agreement, the sample provision specifically records the parties' acknowledgement that they may have different forms of administrative, legislative and judicial systems, and that parties at different levels of development may not achieve the same standards at the same time. The provision goes on to direct that the FET standard set out in the article must be interpreted taking this context into account.
- **Freedom to regulate is specifically recognised:** The sample makes clear that the FET obligation does not preclude the party states from adopting regulatory or other measures to pursue legitimate policy objectives, including measures to meet other international obligations. This provision is not found in other agreements,

144 E.g. ASEAN–Australia–New Zealand FTA (2009) Chapter 11, Art. 6.2(b) ('For greater certainty, fair and equitable treatment requires parties not to deny justice'); US model BIT, Art. 5(2)('"fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world'); ASEAN Investment Agreement, Art. 11.2 ('fair and equitable treatment requires each member State not to deny justice in any legal or administrative proceeding in accordance with the principle of due process'); Netherlands–Oman, Agreement between the Government of the Kingdom of the Netherlands and the Government of the Sultanate of Oman on Encouragement and Reciprocal Protection of Investments, signed 17 January 2009, not yet in force ('Each Contracting Party shall ensure fair and equitable treatment to the investments or nationals or persons of the other Contracting Party and shall not impair, by unjustified or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those nationals or persons').

but reflects the approach taken in some investment arbitration awards and is intended to make clear that a balance is to be struck in applying the requirements of FET, including the protection of investors' reasonable expectations, that takes into account the host state's right and responsibility to regulate.

- **Tribunals are permitted to take into account case-specific factors in assessing compensation:** Consistent with some investor–state tribunal decisions, the sample provision directs tribunals to take into account the circumstances surrounding any breach of FET in assessing the appropriate compensation. These would include the investor's behaviour, such as whether it had been duly diligent in informing itself regarding the risks associated with the investment.[145] This provision is not found in other agreements. The inclusion of such a provision may be unnecessary if a requirement to take into account case-specific factors is included in the general rules governing damages in investor–state arbitration cases. Such an approach is discussed below.[146]

Finally, it is important to note that, even more than other IIA provisions, the scope of an open-ended obligation such as FET may be defined in part by other provisions in an IIA. Statements regarding the goals of the party states in negotiating a treaty in the preamble, an objectives provision or provisions elsewhere in the treaty should inform what protection is afforded by the FET standard in the treaty. The Guide sample provisions have been drafted to provide an appropriate interpretive context by emphasising the relationship between the investment and sustainable development and the right of host states to regulate.[147]

5.5.8 Sample provision: minimum standard of treatment

Minimum Standard of Treatment

1. Each Party shall accord to investments of investors of the other Party treatment in accordance with the customary international law minimum standard of treatment of foreign nationals, including fair and equitable treatment and full protection and security.

2. Fair and equitable treatment means treatment that is not manifestly arbitrary, unreasonable or discriminatory or a gross denial of justice or due process.

3. The concepts of 'fair and equitable treatment' and 'full protection and security' in section 1 do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.

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145 This approach was suggested in UNCTAD (2012), *Fair and Equitable Treatment*, op. cit., at 111. UNCTAD also suggested that damages could be limited to the investor's direct losses, and in no case should be allowed to exceed the amount of capital invested and interest at a commercially reasonable rate. The goal is to ensure that lost profits were not included and that awards would not be too onerous for cash-strapped governments in developing countries.

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

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

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

5. For greater certainty, the Parties recognise that they may have different forms of administrative, legislative and judicial systems, that parties at different levels of development may not achieve the same standards at the same time and that the standard set in this article must be interpreted taking this context into account.

6. This article shall not be interpreted to preclude the Parties from adopting regulatory or other measures that pursue legitimate policy objectives, including measures adopted to comply with other international obligations, so long as the manner in which such measures are implemented is consistent with this article.

7. The amount of any compensation under the Agreement [see Guide Section 7.1 (Investor–state dispute settlement)] to be paid to an investor as a result of a breach of paragraph 1 of this article shall be equitable, taking into account the relevant circumstances of the case.

5.6 Limitations on expropriation and nationalisation

Cross references

Section 5.5 Fair and equitable treatment and the minimum standard of treatment 138
Section 5.12 Reservations and exceptions 224
Section 7.1 Investor–state dispute settlement 408

One of the greatest concerns of foreign investors is that their investments will be expropriated by host-country governments. Existing IIAs permit expropriation so long as certain requirements are met, including the payment of compensation to the investor. While there is a fairly high degree of consensus regarding some of the requirements in IIA expropriation provisions, the types of government actions that constitute an expropriation and the standard for determining the compensation to be paid vary somewhat from one IIA to the next.

It is generally recognised that states have the right to regulate without having to compensate foreign investors for any adverse effects that they experience as a result. The main challenge in drafting expropriation provisions in an IIA is to define the scope of expropriation and the remedies available to investors in a manner that safeguards a state's right to regulate without having to compensate investors for any resulting costs while, at the same time, protecting investors against true expropriations without compensation. It is relatively easy to identify a direct expropriation requiring compensation where a state takes an investor's property for itself. However, states may act in various ways that have an adverse effect on investors without taking their property. In some cases, state actions may deprive the investor of its ability to use or take advantage of its property to such an extent that it is just as if the property had been taken from the investor. Some actions of this kind are characterised as indirect

expropriations requiring compensation. An expropriation provision must address how much a state's action can interfere with an investor's rights of ownership before an expropriation of those rights requiring compensation takes place. In doing so, it is also necessary to take into account the nature and characteristics of the government measure. In most cases, non-discriminatory state regulation to achieve a legitimate public purpose is not considered an expropriation requiring compensation regardless of its effect on an investor.

5.6.1 IIA practice

Apart from any treaty obligations, states have a right to expropriate the investments of both foreign and domestic investors, subject to any requirements in their domestic law and, in the case of foreign investors, customary international law. Though an expropriation is generally a lawful act under domestic laws and customary international law, usually certain requirements must be satisfied. Typically expropriation is permitted only if the following conditions are met:

1. The expropriation is for a public purpose;
2. The expropriation occurs in a non-discriminatory manner;
3. The expropriation occurs in accordance with due process of law; and
4. Compensation is paid.

These requirements are reflected in IIA expropriation provisions as discussed in the next section.

Defining expropriation

The first issue in assessing whether an expropriation requiring compensation has occurred is to determine whether the government action is an expropriation. In defining when an expropriation has occurred, IIAs use different formulations. IIA provisions on expropriation often refer to expropriation that is 'direct' or 'indirect', or to measures 'equivalent to' or 'tantamount to' expropriation, though the use of these terms is not consistent.[148] For example, the UK model treaty applies to nationalisation, expropriation and 'measures having effect equivalent to nationalisation or expropriation'.[149] The US and Canadian models apply to state measures that expropriate or nationalise an investment 'either directly or indirectly'. In the Canadian model, indirect expropriation can occur only through 'measures having an effect that is equivalent to expropriation or nationalization'. Case law decided under NAFTA suggests that measures 'equivalent to' or 'tantamount to'

148 The COMESA Investment Agreement (2007) refers to nationalization and expropriation as well as measures tantamount to expropriation (Art. 20). Most Caribbean BITs and Pacific BITs are similar though some refer to 'equivalent' rather than 'tantamount' to expropriation (Malik, op. cit., at 26, 56).

149 UK model IPPA, Art. 5. The Indian model BIPPA (Art. 3) is substantially similar. The India–Singapore CECA (2005) (Art. 6.5) and ASEAN Agreement (2009) (Art. 14) simply refer to expropriation and nationalization.

expropriation are simply forms of indirect expropriation.[150] In general, there is no evidence to suggest that the different words used in the various models result in different interpretations.[151]

In order to avoid uncertainty regarding whether an indirect expropriation has occurred, some treaties, including the US and Canadian model agreements, provide further guidance on the scope of an indirect expropriation. In the US model, whether or not an indirect expropriation has occurred is to be determined using several criteria:

- An indirect expropriation must have an effect equivalent to a direct expropriation, even though there is no formal transfer of title or an outright seizure;
- The determination of whether an indirect expropriation has occurred requires a case-by-case analysis, including a consideration of the character and economic impact of the government action and the extent to which the action 'interferes with distinct, reasonable investment-backed expectations';[152]
- The fact that a measure or series of measures of a party state has an adverse effect on the economic value of an investment does not by itself establish that an indirect expropriation has occurred; and
- 'Except in rare circumstances,[153] non-discriminatory regulatory measures that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations'.[154]

The US model states that this standard for expropriation is intended to reflect customary international law.[155] The US model also requires that to be an

150 *Pope & Talbot Inc. v. Canada*, op. cit., at 96, 99; and *S D Myers v. Canada*, op. cit., at para. 181.

151 UNCTAD (2011), *Expropriation: A Sequel*, United Nations, New York and Geneva, at 22.

152 See Annex B of the US model BIT, and Annex B.13(1) of the Canadian model FIPA.

153 The IISD model goes farther, providing that *bona fide* measures of this kind *do not* constitute indirect expropriation. This approach is followed in the ASEAN–Australia–New Zealand FTA (2009) Investment Chapter, Annex on Expropriation and Compensation.

154 See Annex B of the US model BIT. The language used in the Canadian model FIPA and the Colombian model agreement is somewhat different (Annex B.13(1) of the Canadian model FIPA; Art. VI.2 of the Colombian model agreement). Similar provisions are found in the Agreement for the Promotion and Protection of Investments between the Republic of Colombia and the Republic of India, signed 10 November 2009, in force 2 July 2012, Art. VI.2(c), China–Peru Free Trade Agreement, signed 28 April 2009, in force 1 March 2010 (Annex 9), COMESA Investment Agreement (2007), Art. 20.6, and Dominican Republic–Central America Free Trade Agreement, signed 2 August 2005, in force 1 January 2009 (Annex 10). See also Australia–Chile Free Trade Agreement, signed 30 July 2008, in force 5 March 2009, Annex. The ASEAN Agreement (2009) has a similar set of factors in Annex 2 to the agreement (2009). See also other agreements listed in UNCTAD (2011), *Expropriation*, op. cit., at 28. See also the IISD model treaty, Art. 8(I). Certain other exclusions are also provided for in that model (Art. 8(H)).

155 This approach is followed in the ASEAN–Australia–New Zealand FTA (2009) Investment Chapter (Art. 9.1) and the Australia–New Zealand Investment Protocol, signed 16 February 2010, not yet in force (Art. 14).

expropriation a state action must interfere with a tangible or intangible property right or interest in an investment, which is narrower than an investment as defined in the US model.[156]

The China–New Zealand FTA includes the same qualifications, but goes beyond the Canadian and US models to provide that:

3. In order to constitute indirect expropriation, the state's deprivation of the investor's property must be:
    a. either severe or for an indefinite period; and
    b. disproportionate to the public purpose.
4. A deprivation of property shall be particularly likely to constitute indirect expropriation where it is either:
    a. discriminatory in its effect, either as against the particular investor or against a class of which the investor forms part; or
    b. in breach of the state's prior binding written commitment to the investor, whether by contract, licence, or other legal document.[157]

Another approach to limiting the scope of expropriation provisions is to include exception clauses in the IIA that carve out measures in particular policy areas from the scope of the treaty. The US and Canadian model treaties, as well as the India–Singapore CECA and the COMESA Investment Agreement, exclude from the application of expropriation provisions state actions to grant compulsory licences of intellectual property rights and to revoke, limit or create such rights, so long as the actions are compatible with the WTO TRIPs Agreement.[158] In addition, under the US model, tax measures may be challenged as an expropriation only if the competent tax authorities of each party fail to agree that the taxation measure is not an expropriation. Some countries also use general exceptions for measures related to areas such as public order and morals, health and the environment that apply to the expropriation obligation.[159]

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156 It has also been replicated in some recent IIAs concluded by other countries: e.g. Australia–Chile FTA (2008) (Annex 10-B); Malaysia–New Zealand FTA (2009) (Annex 7); ASEAN Investment Agreement (2009) (Annex 2); ASEAN–Australia–New Zealand FTA, Annex on Expropriation and Compensation. However, in most IIAs, anything that qualifies as an investment of an investment of another party may be expropriated.

157 Similar language is found in ASEAN–Australia–New Zealand FTA (2009) Investment Chapter, Annex on Expropriation and Compensation.

158 US model BIT, Art. 7(G); Canadian model FIPA, Art. 13.5; India–Singapore CECA (2005), Art. 6.5(6); COMESA Investment Agreement (2007), Art. 20.6; Colombia model agreement, Art. VI.7. The IISD model treaty (Art. 9(G)) is substantially similar.

159 E.g. Canadian model FIPA, Art. 10; COMESA Investment Agreement (2007), Art. 22. General exceptions are discussed below under Section 5.12 (Reservations and exceptions).

Other requirements regarding expropriations

Public purpose

In all IIAs and under customary international law, expropriation, whether direct or indirect, may only be for a 'public purpose'.[160] Some treaties provide that public purpose is to be interpreted in accordance with international law.[161] In practice, a host country has considerable scope to assess for itself what constitutes a 'public purpose'. Indeed, apart from excluding an expropriation that is clearly and solely a reprisal against an investor or that transfers an investor's property to another private party for their own use, there appear to be few limits on the notion of 'public purpose'. While the taking of property must be to further some legitimate public interest, the cases to date does not provide much guidance regarding what constitutes a public purpose.

On a non-discriminatory basis

The requirement in all IIAs that expropriation must occur in a non-discriminatory manner also reflects customary international law. The most obvious example of a discriminatory expropriation is one based on the nationality of the investors.[162] Customary international law's prohibition of discriminatory expropriation does not, however, preclude expropriation where the entire sector is owned by foreign investors or by a particular foreign investor, so long as the state action is motivated by legitimate public policy, is not otherwise discriminatory and is in accordance with due process.

In accordance with due process

The requirement that an expropriation be in accordance with due process has not traditionally been mentioned as a feature of the customary international law of expropriation. However, it is common to the legal systems of most countries that investors must be treated fairly and in accordance with the principles of natural justice. IIAs have increasingly required that host states provide the guarantees of fair treatment contained in the notion of 'due process' to foreign investors.[163] In

160 UNCTAD (2011), *Expropriation*, op. cit., at 48.

161 E.g. Canada–Peru FTA (2008), Art. 811 (footnote 7).

162 *Oppenheimer v. Inland Revenue Commissioner* [1975] 1 *All England Reports* 538; FV Garcia Amador (1959), *Special Rapporteur's Report*, International Law Commission, at para. 62; for other situations of discrimination, see *Sociedad Miner el Tenient S.A. v. Aktiengesellschaft Norddeutsche Attinerie (Chilean Copper Case)*, 12 *International Legal Materials* 251 (Hamburg Superior Court 1973). M Sornarajah (2010), *The International Law of Foreign Investment*, 3d ed., Cambridge University Press, Cambridge, at 398, suggests that expropriations by former colonies of investments of nationals of colonial rulers in the context of achieving independence could be interpreted as discriminatory, since the expropriations solely involved the property of nationals of the colonial power but have nevertheless been permitted in some cases.

163 E.g. India–Singapore CECA (2005), Art. 6.5(1); COMESA Investment Agreement (2007), Art. 20.1; ASEAN Agreement (2009), Art. 14.1; NAFTA (1992), Art. 1110.

practice, due process requires that the expropriation be conducted in accordance with domestic rules, as well as international principles. In particular, there must an opportunity for the investor to have the expropriation decision reviewed by an impartial body that is independent of the state. Typically, recourse to domestic courts or independent administrative tribunals meets this requirement. In the interests of clarity, some IIAs set out specifically that such a right of review is required.[164] Other due process requirements may include prior notice of government acts that are likely to have a significant effect on the investor, such as an expropriation, though the existence of such a requirement is likely to depend on the circumstances. There may be no such requirement where the state is responding to an emergency situation and subsequently provides an opportunity to the investor to seek review of the action.

Compensation requirements

Once a government action is found to be an expropriation, typically the main controversy is over the amount of compensation that is required by international law to be paid to the investor. The standard of 'prompt, adequate and effective compensation' is found most frequently in IIAs.[165] Other standards include 'just compensation', 'equitable compensation' and 'appropriate compensation'.[166] These standards are generally understood as requiring less than full compensation where that is fair in the circumstances, though their precise content is unclear.

Prompt, adequate and effective compensation

In IIAs, the 'prompt, adequate and effective' standard has tended to be proposed by developed countries, while the alternative standards have historically been supported by developing countries, though many developing country agreements also refer to 'prompt, adequate and effective' compensation.[167] Each of the component terms has been given meaning by international tribunals. 'Prompt' means, at a minimum, 'assessed without delay . . . [with] . . . payment to follow soon after.' 'Adequate' means 'the full equivalent in monetary terms of the property taken.' 'Effective' refers to the form of the compensation; compensation should be received in a 'freely transferable currency' to ensure that the recipient can make use of it.[168]

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164 Canadian model FIPA, Art. 13(4), COMESA Investment Agreement (2007), Art. 20.9, UK model BIPPA, Art. 7.3.

165 UNCTAD (2011), *Expropriation*, op. cit., at 62. The various standards in use are summarised at 64–5.

166 The United Kingdom–India, Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of India for the Promotion and Protection of Investments, signed 14 March 1994, in force 6 January 1995, refers to 'fair and equitable' compensation.

167 E.g. India–Singapore CECA (2005), Art. 6.5(2); ASEAN Agreement (2009), Art. 14.1. The typical compensation provision in Caribbean and Pacific BITs is the same (Malik, op. cit., at 28, 57). The COMESA Investment Agreement (2007) requires prompt and adequate compensation (Art. 20.1).

168 E Lauterpacht (1962), 'The Drafting of Treaties for the Protection of Investment,' *International and Comparative Law Quarterly* (Supp. Publ. No. 3) 18 at 27; Sornarajah, op. cit.

Additional standards for the amount *of compensation*

With respect to the standard for the amount of compensation, most agreements now state that compensation has to reflect the actual value of the investment.[169] In some cases, more specific valuation standards such as fair market value are set out. The UK model treaty provides that '[v]aluation criteria shall include the going concern value, asset value including declared tax value of tangible property and other criteria, as appropriate to determine the fair market value'.[170] Some agreements also refer to equitable principles as being relevant to valuation.[171] For example, the COMESA Investment Agreement permits compensation to be adjusted to reflect 'aggravating conduct by the investor' and to be reduced if the investor has not taken reasonable steps to mitigate its loss.[172] Many agreements require states to provide an opportunity for investors to have state valuations reviewed by a domestic judicial or other body.[173]

Most IIAs include an obligation to pay interest[174] from the date of expropriation to the date compensation is actually paid, but there are a variety of approaches regarding the nature of these requirements.[175] One issue is that the date on which an expropriation takes place may be difficult to determine, especially if the government measure at issue is not a straightforward dispossession of the investor's investment. For example, is the date of the expropriation the date of the measure, the date that the measure becomes effective or the date on which the investor is finally dispossessed? A few IIAs deal with this issue by referring to the date on which the investor was dispossessed.[176] Most, however, are silent on this point. In cases of indirect expropriation where it is not clear that there is an expropriation requiring compensation, it is possible to argue that interest should start to run only when there is a finding that an expropriation has occurred.

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169 E.g. IISD model treaty, Art. 8(B); Canadian model FIPA, Art. 13.2; US model BIT, Art. 6; Indian model BIPPA, Art. 5. The draft Norwegian model APPI (Art. 6.1) does not set a valuation standard, but simply refers to satisfaction of 'conditions provided for by law or by the general principles of international law'. The India–Singapore CECA (Art. 6.5(2)), ASEAN Agreement (Art. 14.2(b)), and COMESA Investment Agreement (Art. 20.2) all refer to 'fair market value'.

170 UK Model IPPA, Art. 7.2. See the similar provision in NAFTA (1992), Art. 1110(2), and the Canada–Peru FTA (2008), Art. 812(2).

171 E.g. Chile–South Africa, Agreement between the Republic of Chile and the Republic of South Africa for the Reciprocal Promotion and Protection of Investments, signed 12 November 1998, not yet in force; Australia–Thailand Free Trade Agreement, signed 5 July 2004, in force 1 January 2005.

172 COMESA Investment Agreement (2007), Art. 20.2.

173 E.g. IISD Model Treaty, Art. 8; Canada Model FIPA, Art. 13.4; Indian Model BIPPA, Art. 5(2); India–Singapore CECA (2005), Art. 6.5(4).

174 The India–Singapore CECA (2005) (Art. 6.5(2)) requires interest at an appropriate rate. The ASEAN Agreement (2009) simply refers to 'any accrued interest' (Art. 14.3). The COMESA Investment Agreement (2007) (Art. 20.2) requires interest at a 'commercially reasonable rate'.

175 The IISD Model Treaty (Art. 8(F)) contemplates that where awards are 'significantly burdensome' they may be paid over a period of three years or such other period as the parties agree. The UK–Jamaica BIT (1987) allows some deferral in cases of balance of payment emergencies.

176 The Colombian model agreement fixes the 'date of value' as 'immediately before the expropriatory measures were adopted or immediately before the imminent measures were of public knowledge, whichever is earlier' (Art. VI.3).

There may also be uncertainty regarding the rate at which interest accrues on delayed compensation payments. Interest rates may be specified in IIAs though most are silent on this point too. Some model IIAs refer to interest at a normal commercial rate for the currency of payment.[177] The Indian model treaty requires interest at a 'fair and equitable rate'.[178] Others refer to a specific domestic rate in the host country, such as the government rate on fixed deposits of a certain maturity.[179]

Finally, a few model IIAs deal with the risk to the investor associated with a devaluation of the currency in which payment is made taking place after the expropriation has occurred but prior to payment. The US model BIT provides such protection in cases where payment is not made in a freely usable currency.[180] Some other IIAs provide complete protection against losses resulting from currency devaluation in all circumstances.[181]

Additional standards for the form *of compensation*

Almost all IIAs set some specific requirements for the form of compensation. Some IIAs permit compensation to be in any freely convertible currency[182] or simply require that compensation be effectively realisable and freely transferable.[183] The latter is probably the most flexible standard. Other forms of IIA require compensation in the currency in which the investment was originally made or, with the agreement of the parties, some other convertible currency. Still other models require compensation in a freely usable currency. It will often be preferable for countries to pay compensation in their own currencies. While most currencies qualify as convertible, a 'freely usable currency' is likely to be a much narrower category. Some agreements provide that this expression has the meaning used by the IMF in its Articles of Agreement: currencies widely used to settle international transactions.[184] Only four currencies are recognised by the IMF as meeting this standard: the euro, pound sterling, Japanese yen and US dollar.

177 E.g. UK model IPPA, Art. 5(1).

178 E.g. Indian model BIPPA, Art. 5(1).

179 Vietnam–Finland, Agreement between the Government of the Socialist Republic of Vietnam and the Government of the Republic of Finland on the Promotion and Reciprocal Protection of Investments, signed 21 February 2008, in force 4 June 2009.

180 E.g. US model BIT, Art. 6(4).

181 E.g. Japan–Bangladesh, Agreement between Japan and the People's Republic of Bangladesh Concerning the Promotion and Protection of Investment, signed 10 November 1998, in force 25 August 1999. See also the COMESA Investment Agreement (2007), Art. 20.4.

182 E.g. Canada model FIPA, Art. 13(3).

183 E.g. Indian model BIPPA, Art. 5(1); UK model IPPA, Art. 5(1).

184 Art. XXX(f) defines a freely usable currency as 'a member's currency that the Fund determines (i) is, in fact, widely used to make payments for international transactions, and (ii) is widely traded in the principal exchange markets'. The US model BIT requires that compensation be fully realisable and freely transferable and, if not in a freely usable currency, will have a value equivalent to the value in a freely usable currency (Art. 6(4)).

Additional standards for the timing of payment *of compensation*

Most IIAs provide that payment must be '*prompt*', '*without delay*' or '*without undue delay*'.[185] These timing standards must take into account the normal period of time for payments of the kind in question. In some circumstances, such as where the expropriation is part of a government response to a national emergency, a longer delay may be reasonable. It is not clear to what extent these common formulations would accommodate delays in particular circumstances. The COMESA Investment Agreement provides specifically that payment may be in yearly amounts over a period to be agreed by the investor and the state if payment of an award would be 'significantly burdensome' for the host state. Interest is to be paid at an agreed rate until the full amount is paid.[186]

5.6.2 Understanding what constitutes an expropriation

IIA standards for what constitutes an expropriation triggering a compensation obligation may differ from domestic standards. In addition, the rules regarding expropriation under customary international law differ from the standards established in some IIAs as applied in cases interpreting IIAs. For this reason, it is important to specify in the agreement which body of law is to be applied. The standards of customary international law are often considered to be less onerous for states, though the precise standard is uncertain, difficult to articulate and contested. Whether the customary standard is higher or lower than a particular treaty standard also depends on what the treaty standard requires.

Some investment tribunals interpreting expropriation provisions in IIAs have given a broad meaning to expropriation with the effect of restricting the ability of states to regulate in the public interest. For instance, a few international investment tribunals have found that some forms of state regulation of the environment constituted expropriation.[187] In the remainder of this section the requirements for a finding of expropriation are considered.

Direct expropriation

In general, direct expropriation refers to a situation in which a state takes title to the property of a foreign investor or otherwise transfers the benefit of the foreign

185 E.g. Canadian model FIPA, Art. 13(3)(without delay); US model BIT, Art. 6(2)(b)(without delay); UK model IPPA., Art. 7(2)(without delay); Indian model BIPPA, Art. 5(1)(without unreasonable delay); Colombian model agreement, Art. VI.4 (without unjustified delay).

186 COMESA Investment Agreement (2007), Art. 20(5).

187 E.g. *Santa Elena v. Costa Rica* (2002), 15 *ICSID Review-Foreign Investment Law Journal* 72. This decision was followed in *Tecnicas v. Estados*, op. cit. See also H Mann and K. von Moltke (1999), *NAFTA's Chapter 11 and the Environment*, International Institute for Sustainable Development, Winnipeg; International Institute for Sustainable Development (2001), *Private Rights, Public Problems: A Guide to NAFTA's Controversial Investment Chapter*, International Institute for Sustainable Development, Winnipeg and World Wildlife Fund). The Canadian Government raised this concern in a 1998 issues paper that has not been made public but was reproduced in 17 *Inside US Trade* (12 February 1999) at 20–1. It is discussed briefly in J A VanDuzer (1999), 'What Have We Done? NAFTA States Have Concerns Regarding Investor–state Dispute Settlement Under NAFTA Chapter 11', 25 *Canadian Council of International Law Bulletin* 13.

investor's investment to itself, typically through an outright seizure or other transfer of title.

Indirect expropriation

What constitutes indirect expropriation is much more difficult to define. Indirect expropriation refers to the situation in which the state deprives the foreign investor of the ability to make use of its property in some substantial way, even when title remains with the investor. An indirect expropriation can occur even if the host state does not benefit from the limitation on the foreign investor's ability to use its property. It can also occur through a series of acts, sometimes referred to as 'creeping expropriation'. Defining an indirect expropriation requires specifying the degree of diminished control necessary to qualify as an expropriation. It is impossible to cite a single rule that precisely identifies the degree of control that must be lost for an expropriation to exist that can be applied in all circumstances. Host state actions listed in Box 5.8 are examples of state action that could be found to be an indirect expropriation.[188]

Box 5.8 Host state actions that could be found to be an indirect expropriation

- The host state forces the foreign investor to sell its property.
- The host state forces the sale by a foreign investor of its shares in an investment that is a corporation.
- Indigenisation measures, whereby the host state requires a gradual transfer of ownership from foreign investors to nationals of the host state.
- The host state assumes complete control over the management of an investment of a foreign investor.
- The host state induces others to assume physical possession of the property of a foreign investor.
- The host state fails to provide protection against a taking of the property of a foreign investor.
- Administrative decision-makers cancel licences and permits necessary for the functioning of a foreign investment.
- The host state imposes exorbitant taxes on the foreign investor's investment.
- The host state harasses a foreign investor by, for example, freezing bank accounts or promoting strikes, lockouts and labour shortages, such that it is impossible for the investor to operate.
- The host state expels the foreign investor from its territory in contravention of international law.[189]

188 UNCTAD (2011), *Expropriation*, op. cit., at 30.

189 For a full discussion of these various forms of indirect expropriation, see Sornarajah, op. cit., at 359–95. For examples, see R D Bishop, J Crawford and W M Reisman (2005), *Foreign Investment Disputes: Cases, Materials and Commentary*, Kluwer Law International, The Hague, at 854–83.

The measure must have the same effect as if the investment was directly expropriated

To be an expropriation, a measure must deprive the investor of all or almost all of the value of the investment. The measure must render the economic rights of ownership useless. Some tribunals have referred to the effect on the 'reasonably to-be-expected economic benefit' of the investment to help define what it is that the measure must interfere with.[190] An expropriation may be found where the owner is deprived of control over the investment, such as by the installation of government appointed managers of the investment, even though the owner retains title or physical possession.[191] Other examples are provided in Box 5.9. Where the impact of the measure is not permanent, the duration of the measures is relevant. Some tribunals have concluded that an expropriation could be found even if the measure is only temporary,[192] but when a temporary effect becomes sufficiently serious to constitute an expropriation is not clear.

Box 5.9 Indicators of a loss of control relevant to determining if an investment in an enterprise has been expropriated

- Interference with the direction of the day-to-day operations of the enterprise
- Detention of employees or officers of the enterprise
- Supervision of the work of employees or officers of the enterprise
- Taking the proceeds of enterprise's sales (apart from taxation)
- Interference with management or shareholders' activities
- Preventing an enterprise from paying dividends to its shareholders
- Interference with the appointment of directors or management of an enterprise [193]

None of these factors would necessarily be sufficient on their own, but they would be relevant to a determination as to whether there had been a loss of control of the investment.

Some tribunals have held that to assess the impact of an alleged indirect expropriation it is necessary to consider the effect on all elements of the investment together.[194] This typically involves an examination of the effect of the government action on the

190 *Waste Management v. Mexico*, op. cit., at para. 159.
191 UNCTAD (2011), *Expropriation*, op. cit., at 26, 86.
192 E.g. in *Wena Hotels, v. Egypt*, ICSID Case No. ARB(AF)/00/3, Award, 8 December 2000, at para. 4 (one year). See also *S D Myers v. Canada*, op. cit.
193 These factors were first listed in *Pope & Talbot v. Canada*, op. cit., at para. 100, but have been extensively cited in other investor–state cases.
194 *Telenor Mobile v. Hungary*, ICSID Case No. ARB/04/15, Award, 13 September 2006, at para. 70.

overall business of the investor.[195] Other tribunals have considered the impact of the host state action on any investment that falls within the IIA's definition of investment, such as particular rights under a concession contract or a long-term loan. Under the latter approach, each separate investment is capable of being expropriated.[196] A finding of expropriation will be harder to make if the impact on the entire business held by an investor is considered.

An issue that has arisen in this context is the extent to which contractual rights on their own are capable of being expropriated. In principle, if they are investments within the definition of investment found in the IIA they can be expropriated, but tribunals have determined that not every failure to perform a contract by a state is an expropriation. In general, a state must have gone beyond an ordinary breach of contract. The failure to perform the contract must be associated with an exercise of its sovereign powers. In *Waste Management*, an investor–state tribunal considered a claim by an investor that a municipality's persistent refusal or inability to pay sums that were owed to the investor under a concession agreement to collect waste constituted an expropriation. The tribunal determined that even though the anticipated benefits under the contract were not received by the investor as a result, in part, of actions by the municipality, there was no expropriation of the investor's contractual rights. In order for the rights to be expropriated, the tribunal stated that there would have to be an act of the state in its sovereign capacity, such as legislation or a decree to enact public policy. In addition, the usual civil remedies for breach of contract must have been foreclosed by the state's action.[197] A failure to honour what is, in effect, a commercial obligation of the state is not an expropriation.

Investor expectations concerning the investment may be relevant to assessing the magnitude of the loss to the investor

As noted, the specification of what constitutes an indirect expropriation adopted by some countries in their IIAs refers to an investor's expectations as relevant to determining the magnitude of what the investor has lost. In this regard, the requirement to establish an investor's expectations is likely to be higher in relation to expropriation than as discussed in relation to FET.[198] Tribunals have considered only expectations based on statements of host state officials or expressed in contracts to an investor that have been relied on by the investor.[199] General expectations regarding the stability and predictability of the host state regime have not been found to be sufficient to provide the basis for an expropriation claim.

Regulatory measures that have effects equivalent to expropriation are nevertheless not expropriations

One of the issues addressed by arbitration tribunals is whether a deprivation meeting the standards discussed above is, on its own, sufficient for a finding of expropriation.

195 See, for example, the approach of the tribunal in *Chemtura Corporation v. Canada*, UNCITRAL, Award, 2 August 2010.

196 Dolzer and Shreuer, op. cit.; UNCTAD (2011), *Expropriation*, op. cit., at 42.

197 *Waste Management v. Mexico*, op. cit., at par. 163. See also *Siemens v. Argentina*, op. cit.

198 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).

199 UNCTAD (2011), *Expropriation*, op. cit., at 104.

Some tribunals have considered that deprivation alone is sufficient applying what is called the 'sole effects doctrine'. For these tribunals, the host state's motivation for the measure is irrelevant.[200] Other tribunals have rejected this approach.[201] The inconsistency in tribunal practice has caused some countries to include a specific provision saying that deprivation alone is insufficient.[202] Instead, deprivation is treated as a necessary but not sufficient condition for a finding of expropriation. The character of the measure, including, in particular, whether it is a regulatory act for a public purpose needs to be considered. Thus, while most regulatory measures will not result in a deprivation substantial enough to be considered an expropriation, even if a measure did reach this threshold, it may not be an expropriation.

In general, it is recognised that a state has power to regulate without paying compensation for any resulting negative effects on investors. Traditionally, this has been referred to as the 'police power' of states. The scope of this power to regulate is one of the more complex issues in international investment law. In general, non-discriminatory regulation for a public purpose undertaken in good faith is considered to be valid and not an expropriation,[203] though the existence of such a broad carve-out from expropriation is not universally acknowledged.[204] For this reason, some states have adopted specific language to describe what should be considered regulatory measures that do not constitute an expropriation in their treaty models, as noted above. Some of the elements of regulatory measures are listed below:

- **The measure is taken in good faith for a public purpose:** Under international law, states are presumed to act in good faith. The burden is on the investor to demonstrate a lack of good faith. A measure is not taken for a public purpose simply because a state says that is what it is doing, though significant leeway is accorded to states in this regard.[205] Consideration will be given to whether the measure is within the normal scope of regulatory activity.
- **The measure is non-discriminatory:** This requirement means that the measure does not target a foreign investor based on nationality or other bases of discrimination prohibited under international law.
- **The measure has been implemented in accordance with due process:** In this context, due process means that the process through which the measure was adopted and implemented complies with basic procedural requirements of domestic law and general requirements of procedural fairness.

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200 E.g. *Fireman's Fund v. Mexico*, ICSID Case No. ARB(AF)/01/1, Award, 17 July 2006, at para. 176(f).

201 E.g. *LG&E v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, at paras. 189 and 194.

202 See, for example, Canadian model FIPA, US model BIT and other agreements referred to above. UNCTAD identifies this as a 'clear trend'. UNCTAD (2011), *Expropriation*, op. cit., at 86.

203 UNCTAD (2011), *Expropriation*, ibid., at 110, describing this as the consensus view of commentators, states and investor–state arbitration tribunals.

204 A K Hoffman (2008), 'Indirect Expropriation', in Reinisch (ed.), *Standards of Investor Protection*, op. cit., at 165.

205 *Tecmed v. Mexico*, op. cit., at para. 122.

These requirements overlap substantially with the requirements for a lawful expropriation. Some commentators suggest that, for this reason, there is no general exception for regulatory actions that have effects equivalent to expropriation,[206] though some arbitral awards reflect a different view.[207]

A number of tribunals have required that the measure must bear some plausible relation or be proportional to the achievement of the public purpose.[208] There is no clear consensus on this requirement, however, which is why it is expressly provided for in some IIAs, as discussed above.

When a claim of indirect expropriation arises in an investor–state arbitration case, the state must initially show that the measure was taken for a public purpose, is non-discriminatory and is in accordance with due process to argue that it is within the police powers exception. Then the burden shifts to the investor to show that the state's action did not meet these standards. Overall, the assessment will be tied very closely to the facts surrounding the measure and its adoption and implementation.

5.6.3 Understanding what compensation is required to be paid

Some argue that customary international law requires that compensation for a *lawful* expropriation be 'appropriate' or 'just', and that this means that less than full compensation can be paid in some circumstances.[209] In cases of *unlawful* expropriation, where the customary international law requirements of public purpose or non-discrimination are not met, there is strong authority supporting a requirement to pay full compensation, including any consequential losses.[210] Investment treaties that require compensation at fair market value even for lawful expropriations in effect move the standard for all expropriations, lawful and unlawful, close to the same level. Some argue that this is inappropriate, at least for indirect expropriations in which typically no financial benefit is transferred to the state.[211]

In a recent report, UNCTAD suggests a number of valuation adjustments that states may wish to consider incorporating in their IIAs.[212] A state may want to limit compensation to direct losses not including loss of future profits and prohibit the calculation of compensation based on the discounted value of future profits at the

206 E.g. Hoffman, op. cit., at 165.
207 *Chemtura v. Canada*, op. cit.
208 UNCTAD describes this requirement as 'not universally recognised' in UNCTAD (2011), *Expropriation*, op. cit. at 97.
209 Ibid., at 41.
210 Ibid., at 142–4, citing *The Factory at Chorzów* (Claim for Indemnity) (The Merits), Germany v. Poland, Permanent Court of International Justice, Judgment, 13 September 1929, 1928 P.C.I.J. (ser. A) No. 17. See also A Reinisch (2008), 'Legality of Expropriations,' in Reinisch, op. cit., at 197–8 to the same effect.
211 UNCTAD (2011), *Expropriation*, op. cit., at 148.
212 Ibid., at 148–55.

date of the expropriation.[213] Limiting compensation in this way would reduce the size of awards in some cases, avoid awards of speculative damages and enhance the predictability of damage awards. While the value to an investor of a business at the time of its expropriation may be determined, in part, by the value at that date of the profits that the business might earn in the future, the amount of those future profits and the assessment of their value at the date of expropriation are inherently uncertain. Other bases for valuation, such as the liquidation value (the amount the assets could be sold for net of liabilities on a sale of the investment business) and the book value (the value that the assets are recorded at on the investment's accounting records), are less speculative. Investor–state tribunals have sometimes rejected discounted cash flow valuations as too speculative,[214] though they have been used to assess damages in some cases where the evidence of future cash flows was found to be reliable.[215] No treaty to date has specifically excluded discounted cash flow valuation.

A state may wish to allow investor–state arbitration tribunals to award less than the full fair market value of an investment based on the failure of the investor to mitigate its damages and other equitable considerations, such as when an investor's own actions caused the state to intervene. As noted, such a provision is included in the COMESA Investment Agreement.[216]

UNCTAD also suggests that states consider including an express prohibition on the award of punitive or moral damages. Punitive damages are intended not to compensate the investor for loss but rather to punish the state and send a message to the host state that its actions are not to be repeated. The award of punitive damages is precluded in the US model BIT.[217] In a number of cases, investor–state tribunals, as well as other international bodies, have decided that international law does not

213 The value of future profits is typically calculated using 'discounted cash flows'. Discounted cash flow valuation estimates the cash receipts expected from the investment in each future year of its anticipated economic life less each year's expected cash expenditures. The present value of these net cash flows is calculated by discounting the net cash flow for each year by a discount rate that reflects the expected rate of return on invested funds for the investor's business, taking into account expected inflation and the risk associated with the cash flows. One way to identify the appropriate discount rate is to look at the rate of return available in the same market on alternative investments of comparable risk. See World Bank (1992), *World Bank Guidelines on the Treatment of Foreign Direct Investment*, Washington, D.C.,World Bank.

214 E.g. *SPP v. Egypt*, Award on the Merits, 20 May 1992, at para. 36; *Metalclad v. Mexico*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, at para. 120; and *Tecmed v. Mexico*, op. cit.

215 E.g. *CME v. Czech Republic*, op. cit.

216 COMESA Investment Agreement (2007), Art. 20(2). See the same provision in IISD model treaty, Art. 8(B).

217 This limitation appears in the US model BIT as a general limitation on damages (Art. 34.3). Punitive damages are also excluded in the Canadian model BIT (Art. 44(3)), as well as some existing agreements: NAFTA (1992), Art. 1135(3); Canada–Peru BIT (2008), Art. 44(3); United States–Uruguay BIT (2005), Art. 34(3).

permit the use of damage awards to punish the state for its actions.[218] The goal is compensation for loss.

Moral damages are damages that are intended to compensate the investor, but not for its economic loss. Though the concept of moral damages is not well developed in investment arbitration cases it has a long history in international law and includes damages to compensate for 'mental suffering, injury to … feelings, humiliation, shame, degradation, loss of social position or injury to … credit or to … reputation'.[219] Moral damages have been claimed by investors in a few investor–state arbitrations, but one recent survey found only one case in which such damages have been awarded. In that case, damages of US$1 million were awarded to the claimant to compensate for the malicious infliction of physical duress on the executives of the corporate claimant by the host state and for the loss of reputation by the claimant.[220]

As a practical matter, the circumstances giving rise to a claim for moral damages are likely to be rare in investor–state disputes, which typically centre on economic losses. In expropriation cases, compensation is being sought for the effective taking of a business. Moral injuries are more common in disputes involving other kinds of legal norms, such as human rights. Full reparation may involve compensation for moral damages, but some argue that full reparation is not what is required in all cases of lawful expropriation. Perhaps most important from a host state point of view, an obligation to provide compensation for moral damages is inherently unpredictable, in terms of both the threshold for awarding them and the assessment of the appropriate amount.[221] In addition, some advocates for moral damages in investor–state cases acknowledge that often awards of moral damages are often used both to compensate and to punish state behaviour.[222] Consequently, a state may wish to consider excluding moral damages.

Other limitations identified by UNCTAD as possibilities include (i) giving the state and the investor a period of time to negotiate compensation prior to an award of damages by the tribunal and (ii) providing for situations in which payment of compensation by the state may be delayed, including, for example, a financial crisis. Only the second of these appears in existing treaties.[223]

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218 Commentaries to the Draft Articles on Responsibility of States for Internationally Wrongful Acts Adopted by the International Law Commission at its Fifty-Third Session, November 2001, Report of the ILC on the work of its Fifty-third Session, Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 10 ((A/56/10), Ch. IV.E.2), at 279; and cases cited by P Dumberry (2010), 'Compensation for Moral Damages in Investor–state Arbitration Disputes,' 27 *Journal of International Arbitration* 247 at 276, and B Sabahi (2011), *Compensation and Restitution in Investor–state Arbitration: Principles and Practice*, Oxford, Oxford University Press, at 146–8.

219 Opinion in the Lusitania Cases, United States–Germany Mixed Claims Commission, 1923, VII U.N.R.I.A.A. 32, at 40, cited in P Dumberry, op. cit., at 249.

220 *Desert Line Projects L.L.C. v. Yemen*, ICSID Case No. ARB/05/17, Award, Feb. 6, 2008, cited by P Dumberry, op. cit.

221 Sabahi, op. cit., at 141.

222 Dumberry, op. cit., at 274–5.

223 COMESA Investment Agreement (2007), Art. 20(5). See the same provision in IISD model treaty Art. 8(F).

Box 5.10 Summary of options for expropriation provisions

1. *No obligation to provide compensation for expropriation*
2. *Qualified obligation to compensate for expropriation*

   This obligation would include a prohibition on direct or indirect expropriation of an investment of a foreign investor as defined in the IIA unless the expropriation is for a public purpose, non-discriminatory, in accordance with due process and accompanied by prompt, effective and adequate compensation, but could include a number of limitations on the unqualified obligation described in option 3 below, including any or all of the following:

   a. Clarifications regarding what is to be considered an indirect expropriation:

      i. An indirect expropriation of an investment can occur only when a measure of a state has an effect equivalent to a direct expropriation;

      ii. Whether an indirect expropriation has occurred requires a determination of the economic impact of the state measure, but the sole fact that a measure has an adverse effect on the economic value of an investment is not sufficient for it to be considered an expropriation (rejecting the 'sole effect' doctrine);

      iii. Non-discriminatory state measures that are designed and applied to protect legitimate public welfare objectives do not constitute indirect expropriations.

      These clarifications may themselves be qualified by further providing that:

      1. Limitation (iii) applies 'except in rare circumstances'; or
      2. Imposing an additional requirement that the measure must be in good faith, not arbitrary or disproportionate in light of its purpose;

   b. Limiting the interests protected against expropriation to tangible or intangible property rights, which is narrower than investment as defined in the IIA;

   c. Subjecting the expropriation obligation to exceptions:

      i. Exceptions specific to the expropriation obligation such as a provision that excludes a compulsory licence of intellectual property rights from what is an expropriation;

      ii. General exceptions for measures to protect health, the environment and other policy priorities;

(Continued)

(Continued)

d. Limitations on compensation:

i. Limiting the basic standard to compensation that is 'appropriate', 'just' or 'equitable' rather than 'prompt, effective and adequate';

ii. Limiting compensation to direct losses, not including loss of future profits, and prohibiting the calculation of compensation based on the discounted value of future cash flows;

iii. Allowing investor–state arbitration tribunals to award less than the full fair market value of an investment based on the failure of the investor to mitigate its damages and other equitable considerations;

iv. Prohibiting the award of punitive or moral damages;

v. Giving the state and the investor a period of time to negotiate compensation prior to an award of damages by an arbitration tribunal; and

vi. Providing for situations in which payment of compensation by the state may be delayed, including, for example, a financial crisis.

3. *Unqualified obligation to compensate for expropriation*

a. A prohibition on direct or indirect expropriation of an investment of a foreign investor as defined in the IIA, unless the expropriation is for a public purpose, non-discriminatory, in accordance with due process and accompanied by prompt, effective and adequate compensation;

b. Compensation shall be based on market value of the investment immediately before the time of expropriation;

c. Compensation shall be paid in a freely convertible currency with interest from the date of expropriation;

d. Interest is payable from the date of expropriation until actual payment in full at a specified rate; and

e. Protection is provided against devaluation of the currency of payment from the date of expropriation until actual payment in full.

5.6.4 Discussion of options

1. *No obligation to provide compensation for expropriation*

Since an obligation to provide some compensation for at least some kinds of expropriation is fairly firmly established as part of customary international law, capital-exporting states are very unlikely to accept an IIA with no expropriation provision. Even without a provision, customary international law would still apply, though a customary international law claim for compensation could probably not be enforced

through investor–state arbitration procedures in an IIA. This would depend, however, on the scope of the dispute settlement procedures in the agreement. It is also possible that a treaty-based obligation on a host state to pay compensation for expropriation would be incorporated into an IIA if the IIA contained an MFN clause, and the host state had entered into another IIA that included such an obligation.

2. *Qualified obligation to compensate for expropriation*

   a. Clarifications regarding what is considered to be an indirect expropriation

      The qualifications identified in the summary are present in a significant number of more recent treaties, including the Canadian and US model agreements. They are designed to clarify the standards that exist under customary international law, though some argue that the remaining protection for investors is less than that required by customary international law. Nevertheless, these qualifications represent, at most, an incremental shift from the customary international law standards and are accepted by some major capital-exporting states.

   b. Limiting the interests protected against to tangible or intangible property rights, which is narrower than investment as defined in the IIA

      This qualification is designed to further narrow the circumstances in which an expropriation may be found and excludes expropriation claims that are based exclusively on contractual rights. It is the approach adopted in treaty models used by the USA and some other countries. It also reflects the approach of some investor–state tribunal awards.

      A further limitation adopted by some investor–state tribunals would be to require that all aspects of an investor's investment be assessed in determining whether there has been an expropriation, rather than looking separately at any distinct interest that could qualify as an investment under the IIA definition of that term. Such an approach would limit the circumstances in which an expropriation could be found.

   c. Subjecting the expropriation obligation to exceptions

      Exceptions specific to the expropriation obligation, such as a provision that excludes a compulsory licence of intellectual property rights from what is an expropriation, appear in the treaty model used by Canada and some other countries. Some IIAs entered into by major capital-exporting states and some developing countries, however, do not include them. It is much less common for general exceptions to apply to the expropriation obligation. Some states may view general exceptions for measures to protect health, the environment and other policy priorities as inappropriate for an obligation that already exists in some form in customary international law. They may also view the limitations discussed above on the forms of state regulation that may be found to be an indirect expropriation requiring compensation as sufficient to address the need for policy flexibility, and therefore consider that further exceptions

are duplicative and unnecessary. As a practical matter, there may be few regulatory measures that would fit within these kinds of general exceptions and that would have the same effect as if the investment had been taken from the investor. The vast majority of regulatory measures will have a less significant impact. Nevertheless, some states may still want exceptions because they clearly exclude the application of the expropriation provision and other investor protection obligations from the policy areas identified in the exception and so preserve their policy flexibility in these areas with greater certainty.

d. Limitations on compensation

i. Limiting the basic standard to compensation that is 'appropriate', 'just' or 'equitable', rather than 'prompt, effective and adequate'

Compared with the 'prompt, effective and adequate' standard, all of these other formulations of the basic standard for compensation are used in some IIAs and provide more scope for assessing damages in a way that provides for less than full fair market value compensation in appropriate circumstances, so long as any further specification of the standard in the agreement does not define the compensation required by reference to fair market value. At the same time, however these standards are both less certain and less commonly found than the 'prompt, effective and adequate' standard.

ii. Allowing investor–state arbitration tribunals to award less than the full fair market value of an investment based on the failure of the investor to mitigate its damages and other equitable considerations

These limitations have some basis in investor–state arbitration cases, but they do not reflect a consensus position. The COMESA Investment Agreement permits compensation to be adjusted to reflect any aggravating behaviour of the investor, such as behaviour that might have caused the state to act or otherwise contributed to the loss suffered by the investor, and permits damages to be reduced where the investor has failed to take reasonable steps to mitigate its losses. While few other existing treaties contain such limitations, they are consistent with widely accepted principles for the award of damages under international law.

iii. Prohibiting the award of punitive or moral damages

It is not obvious that investor–state awards where an expropriation has taken place should go beyond what is required to compensate investors for the losses that they have suffered as a consequence of a host state's breach of an IIA obligation. Punitive damages are not intended to provide compensation but to deter future conduct. In addition, punitive damages are prohibited under the US model agreement, and under some other agreements. They are generally not awarded for state actions contrary to international law. This category of damages is also inherently highly discretionary. A prohibition

would prevent such damages from being awarded and ensure that host states would not be at risk of claims for such damages.

Unlike punitive damages, moral damages have been awarded in at least one investor–state case to date. They are intended to compensate for non-economic losses that may be very real, though they are likely to be rare in investor–state disputes, given the essentially economic nature of such disputes. Investor–state tribunals have significant discretion to determine in what circumstances moral damages may be awarded and their amount. They may also be used to sanction state behaviour. In the interests of managing their exposure to liability, states may seek a prohibition on moral damage awards in their IIAs.

iv. Giving the state and the investor a period of time to negotiate compensation prior to an award of damages by the tribunal

A requirement to provide an opportunity for states to negotiate compensation prior to an award would simply ensure that states have a period of time to settle a case, something that the parties could agree to at any time in any case. A treaty requirement would ensure that the tribunal permitted such an opportunity by not awarding damages until the expiry of some period of time after it found the host state to be liable.

v. Providing for situations in which payment of compensation by the state may be delayed, including, for example, a financial crisis

Deferral of payment in some cases may be implicitly permitted in treaties that require payment without 'unjustified delay' or use similar formulations regarding the time within which payment must be made. Under such treaties, some delays must be justifiable. An express provision that identifies the circumstances in which payment may be delayed, however, is rare. Providing for delays in payment would probably be a concern for capital-exporting states and their investors.

vi. Limiting compensation to direct losses, not including loss of future profits, and prohibiting the calculation of compensation based on the discounted value of future cash flows

Excluding compensation for loss of profits and precluding the calculation of compensation on the basis of discounted cash flows, even where they are reliable, could significantly reduce awards in some circumstances. Such a blanket limitation has no basis in existing practice. Consequently, while this kind of limit would reduce the exposure of host states, it may be viewed as inappropriately curtailing the compensation obligation by capital-exporting states and their investors.

All of these kinds of limitations on the damages recoverable could be applied to all investor–state claims and are discussed in more detail in Section 7.1 (Investor–state dispute settlement).

3. *Unqualified obligation to compensate for expropriation*

This is the most demanding version of an expropriation provision. It provides an obligation to pay compensation in relation to any direct or indirect expropriation of a foreign investor from the other treaty party. This model will be most attractive to investors and capital-exporting states because it imposes the highest level of obligation on host states. Most of its elements as set out in Box 5.9 are found in the Indian and German model agreements. Protection against currency devaluation appears in the US model and the COMESA Investment Agreement, but in few others.

5.6.5 Discussion of sample provision

The sample expropriation provision in the Guide takes into account features of the US model BIT, the Canadian model FIPA, the Norwegian draft model APPI, the Indian model BIPPA, the UK IPPA and other treaties. The Guide provision also contains some unique features that differentiate it from many models commonly in use. The goal of the provision is to balance the protection of investors against the expropriation of their investments without compensation with preserving appropriate regulatory flexibility of host states to regulate in order to promote their sustainable development.

Standard set in the treaty is intended to reflect customary international law: The Guide uses the language from the US model BIT to indicate that the standard set in the treaty is intended to reflect and not exceed the standard imposed by customary international law. This has the effect of tying down the discretion of an investor–state tribunal with respect to finding that there has been an expropriation by requiring it to be justified as an expropriation under customary international law. The impact of this limitation is likely to be small, however. Arbitral awards have adopted a variety of approaches to the customary international law standard. Some even argue that particular treaty standards are lower than what is required under customary international law. The limitation in the sample provision may, nevertheless, be useful to make clear that the standard in the IIA is not higher than that under customary international law.

Indirect expropriation does not necessarily occur just because of a loss in value of the investment: The Guide provision adopts the language used in the US and Canadian model treaties and incorporated in an increasing number of IIAs that clarifies, for further certainty, that a government measure that causes a loss in the value of an investment or the failure of an investment to meet the expectations of investors does not of itself qualify as an indirect expropriation.

Indirect expropriation and permitted regulation are distinguished: The Guide sample provision adopts the language used in the US and Canadian model treaties and found in an increasing number of IIAs worldwide that clarifies the meaning of indirect expropriation and distinguishes it from permitted regulation. The sample provision requires that in assessing whether an indirect expropriation has occurred, a case-by-case, fact-based enquiry should be undertaken that considers factors such as

the character and purpose of the government action. The sample provision goes on to provide specifically that governments are able to legislate to achieve a wide range of legitimate public welfare objectives without their actions triggering liability to investors for compensation. In addition to the three examples of legitimate objectives commonly mentioned (public health, safety and the environment), 'economic security' has been added. Also, regulatory actions need only to be designed and applied to achieve such objectives. It is not necessary for states to be able to demonstrate that these objectives will be achieved in fact. The intention is to ensure that measures taken to stabilise the often-fragile economies of developing countries, so as to avoid a severe negative impact on the residents of those countries, will not be considered to be expropriations.

The sample provision also provides that for an expropriation to be found there must be interference with a tangible or intangible property right. This limitation is included in the US model treaty and reflects the decisions of some investor–state arbitration tribunals. It means that state actions in other types of investments that may be within the treaty definition of investment can nevertheless not be challenged as expropriations.

Exceptions are provided: In addition, the Guide sample provision expressly provides that compulsory licensing in a manner consistent with international obligations under applicable international agreements on intellectual property rights, such as the WTO TRIPs Agreement, is not an expropriation. Such an exclusion is provided for in the US and Canadian models and other agreements. The requirement for compliance with international rules binding on the host state is to assure investors that any compulsory licence will meet these standards. This raises the issue that in any case where a state seeks to take advantage of this exception to defeat an investor's claim, the state's compliance with the requirements of TRIPs or other international commitments will be adjudicated by an investor–state tribunal. To avoid this possibility, it could be provided that the compulsory licensing of intellectual property in accordance with the law of the host state does not constitute an expropriation. This approach provides less certainty to investors regarding the circumstances in which compulsory licencing can be used without breaching the expropriation provision.

The Guide includes other sample provisions that provide exceptions and country-specific reservations that could be made applicable to the expropriation obligation. These are discussed below.[224]

Standard of compensation: The basic standard for compensation in the sample provision is that it be 'prompt, adequate and effective'. This is the standard on which IIA practice is converging. While another standard could have been provided, the approach adopted in the sample provision is to adopt the most common standard, but also to include specific limitations on the amount of compensation in the interests of certainty and predictability, as well as to mitigate the concerns that capital-exporting countries will have with other less predictable standards.

224 See Section 5.12 (Reservations and exceptions).

In general, compensation is to be based on the market value of the investment at the time it was expropriated – again, a standard on which IIA practice is converging. Several specific limitations on damages have been included:

- Following the COMESA Agreement, the sample provision allows compensation to be adjusted to reflect any aggravating conduct by the investor or a failure by the investor to take reasonable steps to mitigate its damages. Few other agreements contain these kinds of qualifications. As discussed more fully below, both these qualifications are accepted principles of compensation in international law.[225]
- The sample provision also limits compensation to direct losses, not including loss of future profits, and prohibits the calculation of compensation based on the discounted value of future cash flows. Existing agreements do not contain these kinds of qualifications, but some investment tribunals have declined to award damages for these indirect losses where there was uncertainty regarding future cash flows.
- The sample prohibits the award of punitive damages, following the US model. Punitive damages have not been awarded in investor–state cases to date, but the provision has been included to prevent the introduction of such damages. Moral damages have also been excluded. Moral damages are, in principle, intended to compensate for non-economic losses and have been awarded in at least one case. Nevertheless, they have been excluded in the sample provision on the basis that they are rarely appropriate in an investor–state case and both the threshold for awarding moral damages and the assessment of their amount is inherently unpredictable.
- A provision requiring investor–state tribunals to provide an opportunity for a host state to negotiate compensation after a finding of liability has been included in the sample provisions dealing with investor–state dispute settlement.[226]

Form of payment: The only restriction on the currency in which payment is made is that it is freely convertible. So long as a state's currency meets this standard, it may use its own currency for payment. This approach reflects the practice in most IIAs. No provision has been included to shift the risk of currency devaluation between the date of expropriation and the date of payment to the state. Few IIAs contain such provisions.

Time of payment: The sample provision provides that there may be situations in which payment of compensation by the state is so burdensome that it must be delayed. One situation in which this might occur would be a financial crisis. This provision is based on the COMESA Investment Agreement. Few other IIAs have such a provision. Most simply require payment without delay. Accordingly, this provision may be a concern to capital-exporting states and investors. To address this concern, where payment is delayed, compensation must be accompanied by the payment of interest at a reasonable commercial rate for the currency in which the payment is made, consistent with the approach in the COMESA Investment Agreement.

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225 See Section 7.1 (Investor–state dispute settlement).
226 See Section 7.1 (Investor–state dispute settlement).

Right to review of expropriation and compensation decisions: Consistent with widespread IIA practice, the sample provision gives an investor a right to seek review in the host state of host state decisions regarding expropriation and the value of any compensation paid. The sample dispute resolution provision in Section 7.1 (Investor–state dispute settlement) provides that these kinds of domestic procedures will have to be exhausted before an investor may commence investor–state dispute settlement proceedings to seek relief for expropriation or any other breach of an IIA.

5.6.6 Sample provision: expropriation and compensation

Expropriation and Compensation

1. Neither Party may expropriate or nationalise an investment of an investor of the other Party, either directly or indirectly through measures equivalent to expropriation or nationalisation (all of which are referred to in this Article as an 'expropriation'), except:
   a. For a public purpose;
   b. In a non-discriminatory manner;
   c. On payment of prompt, adequate and effective compensation in accordance with sections 2 and 3 of this article; and
   d. In accordance with due process of law.
2. The compensation referred to in subsection 1c. shall be paid without unjustified delay and be effectively realisable and freely transferable. Such compensation shall be in a freely convertible currency and include interest from the date of the expropriation, defined as the date upon which the measure constituting the expropriation becomes effective in relation to the investor, until the date of payment at a reasonable commercial rate for the currency in which payment is made.
3. The compensation referred to in subsection 1c. shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place and not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria may include asset value, including declared tax value of tangible property and other criteria, as appropriate, to determine fair market value provided that compensation (i) shall be limited to direct losses of the investor, (ii) shall not include loss of future profits or be calculated on the basis of the discounted value of future cash flows, (iii) shall be adjusted to reflect any aggravating conduct by the investor, including conduct that caused the state to take the action that constitutes an expropriation, or a failure by the investor to take reasonable steps to mitigate its damages, and (iv) shall not include punitive or moral damages.
4. An investor of a Party affected by an expropriation shall have a right, under the law of the Party making the expropriation, to prompt review, by a judicial or other independent authority of that Party, of the decision to expropriate and of

the valuation of its investment in accordance with the principles set out in this article.

5. This article does not apply to the issuance of compulsory licences granted in relation to intellectual property rights, or to the revocation, limitation or creation of intellectual property rights, to the extent that such issuance, revocation, limitation or creation is consistent with applicable international agreements on intellectual property rights binding on both Parties.

6. For greater certainty, this article is intended to reflect customary international law concerning the obligation of states with respect to expropriation.

7. An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment.

8. Proof that an action or series of actions by a Party has an adverse effect on the economic value of an investment of an investor of the other Party or interferes with the investment-backed expectations of the investor, standing alone, does not establish that an expropriation has occurred. The determination of whether an action or series of actions constitutes an expropriation requires a case-by-case, fact-based enquiry considering factors such as the character and purpose of the government action. A non-discriminatory measure by a Party that is designed and applied to achieve legitimate public objectives, such as the economic security of residents, public health, safety, the protection or promotion of internationally and domestically recognised human rights, labour rights, the rights of indigenous peoples, social justice and the protection of the environment, does not constitute an expropriation.

5.7 Compensation for losses

Cross references

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Many IIAs deal with losses experienced by foreign investors in connection with war, civil disturbance and other extraordinary events separately from expropriation. Because of the exceptional nature of these kinds of events, often they are not covered by private insurance. Customary international law is generally understood as not requiring compensation in these circumstances, unless the state has failed to act in a duly diligent way. Consequently, protection in the form of an IIA commitment is often sought.

5.7.1 IIA practice

Traditionally, almost all IIAs contain some kind of provision dealing with the protection of investors in extraordinary circumstances,[227] but there are some variations in their scope. Some are limited to damage caused by people,[228] while others extend to losses resulting from natural disasters[229] and, in a few cases, a broad and undefined category of national emergency.[230]

In situations that are covered, the compensation obligations vary. In most treaties, investors of party states are required to be accorded treatment no less favourable than that accorded to investors of other states with respect to any compensation, restitution or other settlement, a version of MFN treatment.[231] Many others guarantee treatment no less favourable than that accorded to domestic investors, a form of national treatment.[232] A third category of IIAs provides MFN and national treatment where losses are caused by human activity, but only MFN treatment in the case of losses due to natural disaster.[233] However structured, provisions of this kind do not specify standards for the compensation required because, unlike IIA provisions dealing with expropriation discussed above, the standard is a relative one determined by reference to the treatment of others.

A few IIAs provide an absolute obligation to compensate for a limited category of losses occasioned by actions of the host state's armed forces.[234] For this category of

227 Mexico–Argentina, Agreement between the Government of the United Mexican States and the Government of the Republic of Argentina for the Promotion and Reciprocal Protection of Investments, signed 13 November 1996, in force 22 June 1998, is an exception.

228 E.g. US model BIT, Art. 5.4 (losses limited to losses due to armed conflict or civil strife).

229 E.g. Canadian model FIPA, Art. 12 (losses to due armed conflict, civil strife or natural disaster).

230 E.g. Indian model BIPPA, Art. 6 (losses limited to war or other armed conflict, a state of national emergency or civil disturbance). See also India–Singapore CECA (2005), Art. 12; ASEAN Agreement (2009), Art. 12. The COMESA Investment Agreement (2007) (Art. 21.3) has a similar provision except that natural disasters are specifically excluded.

231 E.g. Ethiopia–Malaysia, Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of Malaysia for the Promotion and Protection of Investments, signed 22 October 1998, in force 25 June 2004.

232 E.g. COMESA Investment Agreement (2007), Art. 21.1; Indian model BIPPA, Art. 6; India–Singapore CECA (2005), Art. 12; Canadian model FIPA, Art. 12 (simply referring to non-discriminatory treatment); US model BIT, Art. 5.4 (simply referring to non-discriminatory treatment).

233 E.g. Mexico–Cuba, Agreement between the United Mexican States and the Republic of Cuba for the Promotion and Reciprocal Protection of Investments, signed 30 May 2001, in force 29 March 2002.

234 E.g. US model BIT, Art. 5.5 (limited to losses due to requisitioning of the investment by host state armed forces and unnecessary destruction by armed forces); COMESA Investment Agreement (2007), Art. 21.2.

loss, some IIAs impose compensation requirements that are the same as those for expropriation,[235] while others set a different standard.[236]

Box 5.11 Summary of options for compensation for losses provision

1. *No obligation to provide compensation for losses*
2. *Compensation for losses provision limited to MFN treatment and/or national treatment or both and limited to particular kinds of causes*

   Causes triggering the obligation may include any or all of the following:

   a. War, armed conflict and civil disturbance

   b. Natural disasters

   c. National emergencies
3. *Compensation for losses provision that requires compensation in limited circumstances in addition to when compensation is required by MFN and national treatment*

5.7.2 Discussion of options

1. *No obligation to provide compensation for losses*

Even if no compensation for losses provision were included in an IIA, a state would still be bound to provide MFN treatment and national treatment with respect to its treatment of foreign investors to the extent that it had agreed to those obligations in the IIA. Consequently, if an IIA contains MFN and national treatment obligations, they may apply in relation to the compensation paid by a state for losses, even if there is no separate compensation for losses provision. In addition, a reasonable level of protection of foreign investors would be required under any full protection and security provision agreed to.

It is also possible that an obligation on a host state to pay compensation for losses would be incorporated into an IIA, if (i) the IIA contained an MFN clause, and (ii) the host state had entered into another IIA that provided such an obligation.

235 E.g. US model BIT, Art. 5.5 (requiring 'prompt, adequate and effective' compensation in accordance with the expropriation provision in the model).

236 E.g. Hong Kong–United Kingdom, Agreement between the Government of the Hong Kong Special Administrative Region of the People's Republic of China and the Government of the United Kingdom of Great Britain and Northern Ireland for the Promotion and Protection of Investments, signed 30 July 1998, in force 12 April 1999 (restitution or reasonable compensation); Mauritius–Singapore, Agreement between the Government of the Republic of Mauritius and the Government of the Republic of Singapore for the Promotion and Protection of Investments, signed 4 March 2000, in force 19 April 2000 (domestic standard). The IISD model treaty prohibits investors from assisting in or being complicit in violations of human rights committed by third parties or by the host state or its agents at any time, including during civil strife (Art. 14).

2. *Compensation for losses provision limited to MFN treatment and/or national treatment or both and limited to particular kinds of causes including any or all of the following: (i) war, armed conflict and civil disturbance; (ii) natural disasters; and (iii) national emergencies.*

If the host state's obligation is limited to providing treatment no less favourable than the treatment it provides to other foreign investors (the MFN obligation), it remains able to prefer national investors. This gives more flexibility to host states than a national treatment obligation, but less protection to foreign investors. Capital-exporting states and their investors would prefer national treatment. It is not clear in most treaty models how these protections differ from the basic MFN and national treatment obligation found in most IIAs. Their main purpose is to clarify that these obligations apply even in the extreme circumstances contemplated.

In terms of the causes of losses triggering a compensation obligation, natural disasters are out of the state's control and may create enormous and unpredictable stresses on host states. In these situations, the compensation of nationals might be the first priority and paying the same compensation to foreigners might be an onerous burden. National emergencies, which could include natural disasters, are an open-ended and unpredictable category of situations where host states may, at least in some circumstances, want to favour nationals. As with natural disasters, a national treatment obligation could prove to be a heavy burden. An MFN obligation would trigger obligations in practice only if the state compensated some foreigners. As a result, the MFN obligation would impose a more limited burden and one that the state is in control of by its actions related to the payment of compensation to foreigners.

War and civil disturbance are the most specific and narrowest category of events triggering an obligation to compensate for losses and are the subject of some protection in almost every agreement. Nevertheless, a national treatment commitment may prove onerous, depending on the magnitude of the events. An MFN commitment would be more manageable for host states.

If national treatment is to be avoided, however, the IIA should make sure that the general national treatment obligation is drafted in such a way as to exclude any payments to nationals to compensate for losses due to any of the identified causes.

No matter what limitations are imposed on compensation for losses, it also possible that a higher obligation on a host state to pay compensation for losses would be incorporated into an IIA if the IIA contained an MFN clause and the state had entered into another IIA that provided a more demanding compensation obligation, including, for example, a mandatory compensation obligation as described in option 3.

3. *Compensation for losses provision that requires compensation in limited circumstances in addition to when compensation is required by MFN and national treatment*

This is the most onerous provision for host states, but provides the best protection for investors. Treaties generally limit this kind of mandatory compensation obligation to losses caused by the host state requisitioning or destroying an investor's property,

other than during combat or where required by the necessity of the situation. In some circumstances, these kinds of acts may trigger compensation under an IIA's expropriation provision even where no specific compensation obligation is included in the IIA. The obligation to compensate in these circumstances could be excluded in some cases on national security grounds if an appropriate exception is included in the IIA.[237]

In a very narrow range of circumstances, a state may be able to avoid its IIA obligations by relying on general customary international law rules dealing with *force majeure* and necessity.[238] *Force majeure* refers to situations that are beyond the control of the state that make it impossible for the state to comply with its obligations. A state may rely on necessity to justify its actions where those actions are the only means to protect its essential interests against a serious and imminent peril.

5.7.3 Discussion of sample provision

The Guide sample provision adopts the standard used in the US model BIT, which simply prohibits discrimination by the host state government with respect to whatever measures it undertakes to respond to armed conflict or civil strife contrary to the MFN obligation. This is the narrowest specification of the causes triggering a compensation obligation in existing IIAs. In this context, discrimination by a party state against investors from other party states would include more favourable treatment of foreign investors from non-party states. The standard for discrimination is defined by reference to the MFN provision in the IIA.[239] By setting a relative standard that is measured against compensation meted out to others, this provision leaves considerable discretion to the host state to decide what compensation is appropriate, taking its means into account.

The less predictable categories of situations referred to in some other treaties, such as natural disasters and national emergencies, do not give rise to obligations under the sample provision. The sample provision provides that the general MFN and national treatment obligations do not apply to state actions in response to these situations. No mandatory compensation obligation has been included for any particular kind of action. Such an obligation may be onerous for states that may be unable to compensate their own nationals and is included in only a few treaties. It is possible that a general expropriation obligation in an IIA may apply in any case where the action of the state constitutes an expropriation subject to any applicable general exception.[240]

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237 See Section 5.12 (Reservations and exceptions).

238 These customary international law rules are codified in the ILC Draft Articles on State Responsibility, op. cit., Arts. 23 and 25.

239 See Section 5.3 (National treatment) and Section 5.4 (Most favoured nation). This approach follows the Norwegian Draft model APPI, Art. 7.

240 See Section 5.6 (Limitations on expropriation and nationalisation).

In the sample provision, an additional specific exclusion has been inserted that provides that investors are not entitled to the benefit of the article if they have been complicit in serious violations of human rights in connection with the armed conflict or civil unrest. This limitation does not exist in any IIA and may be a concern for capital-exporting states and their investors. Nevertheless, it has been included in the sample provision to create an incentive for investors to avoid such violations.

Sections 6.7–6.11 (obligations of investors) discuss sample provisions that complement this limitation. Sample provisions provide examples of standards for investors in relation to their observance of domestic law in the host state, including laws relating to human and labour rights, and the rights of indigenous peoples, as well as prohibitions on complicity in serious violations of human rights, and bribery and corruption. These sample provisions contemplate that in circumstances in which investors engage in conduct which breaches these standards, they may be held civilly liable to the host state or persons of the host state who suffer losses as a result in the domestic courts of the investor's home state, as well as in courts in the host state. They also provide that investors may be held criminally liable for violating prohibitions on complicity in corruption or serious violations of human rights.[241]

5.7.4 Sample provision: compensation for losses owing to armed conflict or civil strife

Compensation for Losses Owing to Armed Conflict or Civil Strife

1. Each Party shall accord to investors of the other Party and to their investments treatment in accordance with [Guide sample provision in Section 5.4 (Most favoured nation)] with respect to measures it adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict or civil strife. [Guide sample provision in Section 5.3 (National treatment)] shall not apply to measures referred to in this section.

2. [Guide sample provision in Section 5.4 (Most favoured nation)] and [Guide sample provision in Section 5.3 (National treatment)] shall not apply to measures adopted or maintained by a state in response to a natural disaster or national emergency.

3. Section 1 shall not apply to investors of the other Party or to their investments where such investors or investments are complicit in the perpetration of egregious violations of human rights, including war crimes, crimes against humanity, genocide, torture, extra judicial killing, forced disappearance and forcible displacement, in the Party in connection with armed conflict or civil strife referred to in section 1.

241 See Section 6.13 (Enforcement of investor obligations).

5.8 Free transfer of funds

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Section 5.2 Right of establishment 104
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Most IIAs provide some form of guarantee regarding an investor's freedom to transfer funds related to its investment out of the host state.[242] Investors consider flexibility to repatriate profits made from their investment, proceeds from the sale of the investment and other funds associated with their investment to be fundamentally important. On the other hand, states need a certain amount of flexibility in order to deal with problems such as capital flight and, more generally, to manage their monetary and financial policies, and to engage in law enforcement that may require limiting international transfers in some circumstances. Developing countries are especially vulnerable to sudden and significant financial flows that may require regulation.

Agreements that contemplate a right of establishment typically also provide for a right to transfer funds *into* host states.[243] Such rights complement and reinforce the investor's right to enter and operate in a host state.

Traditionally, many IIAs contained unqualified prohibitions on host state restrictions related to the transfer of funds by investors. In many more recent IIAs, transfer of funds provisions seek to accommodate the interests of host states and investors in a more balanced way by creating a basic prohibition on transfer restrictions, but listing extensive exceptions to provide host states with the flexibility that they need to engage in necessary financial and monetary management and law enforcement.

5.8.1 IIA practice

Transfers covered

Most IIAs commit host states to ensuring that investors can transfer funds related to their investments out of the host state without delay and in a specific currency.[244] As noted, agreements that provide a right of establishment typically also provide for a right to transfer funds into host states.[245] Usually the same obligations regarding freedom for transfers and any exceptions apply equally to transfers into and out of the host state.

242 E.g. IISD model treaty, Art. 11; Canadian model FIPA, Art. 14; US model BIT, Art. 7; Indian model BIPPA, Art. 7; UK model IPPA, Art. 6; Norwegian Draft model APPI, Art. 9; India–Singapore CECA (2005), Art. 6.6; ASEAN Agreement (2009), Art. 13; and the COMESA Investment Agreement (2007), Art. 15.

243 E.g. Canadian model FIPA, Art. 14; US model BIT, Art. 7.

244 Ibid. Most Caribbean and Pacific BITs contain such a provision (Malik, op. cit., at 29, 58).

245 E.g. Canadian model FIPA, Art. 14; US model BIT, Art. 7; ASEAN–Australia–New Zealand FTA (2009) Investment Chapter, Art. 5.1.

There are, however, differences in approach regarding whether the right to transfer applies to all funds or only to specific types of funds listed exhaustively in the agreement. The Canadian, US, UK, Indian, Norwegian and IISD models all extend the transfer requirement to all funds related to an investment and provide an extensive illustrative list of types of funds.[246] This is the most common approach.[247] The COMESA Investment Agreement sets out an exhaustive list of transfers that a member state is obliged to permit.[248] Often the wording of exhaustive list provisions is broad enough to cover most transfers that investors would want to make in practice.

Some IIAs limit the free transfer obligation by making it 'subject to its laws and regulations'. The COMESA Investment Agreement adopts this approach, which means that a host state is prohibited from applying only restrictions on transfer that are different from those that exist from time to time under its law.[249] Such an approach gives maximum flexibility to host states, but limited assurance to investors regarding their ability to transfer funds. Host states can define the rules regarding transfers of funds as they choose so long as the rules are in accordance with national law.

One final variation found in a few IIAs is to permit transfers out of the host country, but only after capital has been invested for a minimum period of time, usually a year, as in the Chile–Austria BIT.[250]

Currency in which transfers are to take place, applicable exchange rate and time frame

Another issue related to the design of funds transfer provisions is the currency in which transfers must be permitted. The UK, Indian and Canadian model agreements all provide that transfers are to be permitted in the currency originally used for the investment or any other freely convertible currency agreed on by the parties.[251] The US, Norwegian and IISD models simply require that transfers be permitted in a freely usable currency.[252] As noted above, 'freely usable currency' may be given the precise and limited meaning attributed to the expression under the IMF Articles of

246 E.g. ASEAN–Australia–New Zealand FTA (2009) Investment Chapter, Art. 5.1. The same approach is followed in the India–Singapore CECA (2005) (Art. 6.6 (1)); the ASEAN Agreement (2009) (Art. 13.1); and the Mauritius–Singapore BIT (2000) (Art. 8). The UK model IPPA (Art. 6) refers to the 'unrestricted transfer of [investors'] investments and returns'.

247 UNCTAD (2007), *Bilateral Investment Treaties*, 1995–2007, op. cit., at 61.

248 COMESA Investment Agreement (2007), Art. 15. Some other existing BITs contain similar language: e.g. China–Jamaica BIT (1994); Colombian model agreement, Art. V.

249 COMESA Investment Agreement (2007), Art. 15. Some other existing BITS contain similar language: e.g. China–Jamaica BIT (1994).

250 Chile–Austria, Agreement between the Republic of Chile and the Republic of Austria for the Promotion and Reciprocal Protection of Investment, signed 8 September 1997, in force 22 October 2000, *Ad* Art. 4(1).

251 UK model IPPA, Art. 8. Indian model BIPPA, Art. 7(3) (no agreement of the parties required); Canadian model FIPA, Art. 14.2.

252 US model BIT, Art. 7.2; IISD model treaty, Art. 11(B). See, similarly, ASEAN–Australia–New Zealand FTA (2009) Investment Chapter, Art. 5.2.

Agreement.[253] Only the euro, Japanese yen, US dollar and UK pound sterling are recognised as freely usable currencies.

Most agreements provide that the exchange rate applied to funds transferred should be the rate in effect at the date of the transfer.[254] The Indian model treaty and the Canadian model treaty refer to the 'market rate'.[255] The UK model, however, refers to the 'rate of exchange applicable on the date of transfer pursuant to the exchange regulations in force'.[256] In either case, if the host state has a floating currency exchange rate, the market will determine the applicable rate. For the first group of IIAs that refer to a 'market rate', it is not clear what happens if there is no market rate. In the case of the UK model, if a state has an officially administered exchange rate, that rate will be applied. Resort to the official rate may be advantageous or disadvantageous to the investor depending on the circumstances.[257] If the host country has an overvalued official exchange rate, investors will be disadvantaged because they will receive less foreign currency than under a market rate. Equally, if the official rate is artificially low, investors will receive a benefit.[258]

In terms of timing, most IIAs that address the issue require that transfers be permitted without delay. The India–Singapore CECA requires only that the transfer be permitted without 'undue delay'.[259] It is also possible to stipulate a maximum time period.[260]

Exceptions to funds transfer obligations

Neither the Indian nor the UK model treaty provides any exception to the funds transfer obligations. In contrast, many agreements set out an extensive list of circumstances in which transfers may be restricted for the application and enforcement of laws in particular areas. The Canadian, US and IISD models all contemplate that transfers may be restricted in connection with the good faith, non-discriminatory application of a state's laws relating to:

- Bankruptcy, insolvency or the protection of the rights of creditors;
- Issuing, trading or dealing in securities;
- Criminal or penal offences;

253 See Section 5.6 (Limitations on expropriation and nationalisation).

254 The IISD model treaty, Art. 11(B); US model BIT, Art. 7.2.

255 Indian model BIPPA, Art. 7(3); Canadian model FIPA, Art. 14.2. See, similarly, ASEAN–Australia–New Zealand FTA (2009) Investment Chapter, Art. 5.2.

256 UK model IPPA, Art. 8.1; US model BIT, Art. 7.1; Canadian model FIPA, Art. 14.1; ASEAN–Australia–New Zealand FTA (2009) Investment Chapter, Art. 5.1. Timing is not addressed in the COMESA Investment Agreement (2007).

257 This issue is not addressed in the Norwegian Draft model APPI.

258 Some treaties provide that, where there is no market rate, the rate shall be the cross rate obtained from those rates which would be applied by the International Monetary Fund on the date of payment for conversions of the currencies concerned into Special Drawing Rights; e.g. German model treaty, Art. 7(2).

259 India–Singapore CECA (2005) Art. 6.6 (1). The Indian model BIPPA refers to 'without unreasonable delay' (Art. 7(3)).

260 UNCTAD (2007), *Treaties 1995–2007*, at 61.

- Reporting regarding currency or other financial transfers; and
- Ensuring compliance with orders or judgments in judicial or administrative proceedings.

These kinds of restrictions are commonly imposed in practice by many countries. For example, a bankrupt foreign investor operating in host state will not be permitted to transfer is assets out the country to defeat the claims of local creditors. A similar list of exceptions is included in the India–Singapore CECA and the ASEAN Agreement.[261] The ASEAN Agreement adds taxation, social security, public retirement and compulsory savings programmes, as well as requirements for severance payments to employees as laws in relation to which restrictions on transfer of funds are permitted.

A number of agreements contain provisions that permit countries to restrict transfers in connection with the regulation of financial institutions, though the majority of IIAs do not contain such provisions.[262] For example, Canada's model permits restrictions on transfers by financial institutions in some circumstances in the interests of maintaining the soundness and integrity of financial institutions. These kinds of measures are sometimes referred to as based on 'prudential' considerations.[263]

Other treaties permit states to restrict transfers in balance of payments emergencies.[264] Such an emergency occurs when a host state's foreign currency reserves are exceptionally low. During such a period it will be extremely difficult for the state to convert its own currency into foreign currencies for the purpose of providing foreign currency for transfers of funds related to investments. In IIAs that contain such a limitation, it is common to require that restrictions on transfers be temporary, in accordance with IMF requirements,[265] and applied in good faith and on a non-discriminatory basis. These requirements are intended to assure foreign investors that host state restrictions for balance of payments purposes will not be imposed lightly or in ways that would disadvantage them in comparison with local investors. The IMF requirements do not relate to restrictions on capital transfers. Under the IMF rules, a member is prohibited from restricting payments related to current transactions, without the approval of the IMF. These include regular payments in connection with business activities, such as payments for goods and services, short-term bank loans

261 India–Singapore CECA (2005), Art. 6.6(2); ASEAN Agreement (2009), Art. 13.3.

262 Malik, op. cit., at 29.

263 Canadian model FIPA, Arts. 14.6 and 14.7. Some other agreements subject the transfer guarantee to domestic law generally. Some treaties have a general exception for a broader class of prudential measures as discussed below, e.g. US model BIT, Art. 20. See Section 5.12 (Reservations and exceptions).

264 IISD model treaty, Art. 11(G). Some broader formulations are also found. The India–Singapore CECA (2005) allows restriction on payments in the event of 'serious balance of payments or external financial difficulties' (Art. 6.7). In the Papua New Guinea–Australia BIT, a party may restrict payments in 'exceptional financial or economic circumstances'. The ASEAN–Australia–New Zealand FTA (2009) Investment Chapter has a similar list (Art. 5.3).

265 *Amended Articles of Agreement of the International Monetary Fund* (1992) 31 *International Legal Materials* 1309. Article VIII, section 2(a) prohibits restrictions on 'the making of payments and transfers for current international transactions' without the approval of the IMF.

and transfers of income from a business. Payment of proceeds from the sale of an investment is an example of a capital payment.

GATT and *GATS* require compliance with IMF requirements if restrictions are to be imposed on international transfers related to current transactions in goods and services.[266] These obligations apply to all WTO members. *GATS* obligations apply only in relation to sectors that a member has listed in its national schedule of commitments. *GATS* goes on to provide that in sectors where a member has undertaken market access commitments, it cannot impose restrictions on related capital transfers.[267]

Referring to compliance with the IMF requirements as a condition of eligibility for an IIA exception means that where a state seeks to take advantage of this exception to defeat an investor's claim that a state has breached a free transfer of funds obligation, the state's compliance with the IMF's requirements will be adjudicated by an investor–state tribunal. This may be considered anomalous since the IMF rules are not directly enforceable at the instance of private parties in other contexts. An alternative approach that avoids this problem would be simply to say that a state might restrict payments to address a balance of payments emergency and leave it up to an investor–state tribunal to apply that provision to the situation in which a state has acted. Such an approach, however, provides less certainty to investors.

It is also possible that a state might be able to justify a restriction on transfers of funds based on exceptions in an IIA that permit it to take action to protect its essential security interests, notwithstanding any obligation in the IIA.[268] Security exceptions are discussed below.[269]

Box 5.12 Summary of options for transfer of funds provision

1. *No obligation to permit transfer of funds*
2. *Obligation to permit the transfer of funds with exceptions and qualifications*
   a. Open or closed list of transfers that must be permitted
   b. Subject to exceptions

   As noted above, many IIAs contain detailed lists of situations in which restrictions are permitted, including the application of laws in some or all of these areas.

   i. Bankruptcy, insolvency or the protection of the rights of creditors

(Continued)

266 *GATT*, Art. XV, I Arts. XI and XII. Both *GATT* and *GATS* impose some additional requirements. *GATS* limits a member's ability to impose restrictions to situations involving a 'serious balance-of-payments and external financial difficulties or threat thereof'.

267 *GATS*, Arts. XI and XVI, footnote 8.

268 The OECD's Code of Liberalization of Capital Markets and Code of Liberalization of Invisible Operations both contemplate the possibility of restrictions in these circumstances.

269 See Section 5.12 (Reservations and exceptions).

(Continued)

ii. Issuing, trading or dealing in securities

iii. Criminal or penal offences

iv. Reporting regarding currency or other financial transfers

v. Ensuring compliance with orders or judgments in judicial or administrative proceedings

vi. Taxation

vii. Social security, public retirement and compulsory savings programmes

viii. Payments of remuneration and severance to employees.

Other exceptions in IIAs allow the restriction of payments by financial institutions in connection with prudential management to ensure the maintenance of the safety, soundness, integrity and financial responsibility of financial institutions and to address balance of payments emergencies.

3. *Unqualified obligation to permit transfer of funds*

5.8.2 Discussion of options

1. *No obligation to permit transfer of funds*

Based on existing IIA practice, not including a funds transfer obligation in an IIA would be very unusual. A transfer of funds provision grants protection to investors regarding what may be the most important business objective of their investment, to repatriate capital and profits to their operation in their home state. Not having a transfer of funds provision would be a significant gap in investor protection. At the same time, a transfer of funds provision can be useful to host countries because it clearly sets out what restrictions on transfers are permitted and insulates states that impose such restrictions from challenge by investors through investor–state arbitration. In addition, the general commitment not to restrict transfers may encourage investment on the basis that it ensures that investors can repatriate returns and other financial flows from their investments.

Even if no transfer of funds obligation is included in an IIA, it is possible that such an obligation on a host state would be incorporated into an IIA if (i) the IIA contained an MFN clause and (ii) the state had entered into another IIA that provided such an obligation. In addition, certain kinds of restrictions on transfers may be characterised as inconsistent with an IIA obligation to provide fair and equitable treatment or, in extreme cases, an IIA obligation not to expropriate without compensation, depending on their nature and their manner of implementation.[270] To avoid the application of these provisions, an express exception would be required.

270 A Kolo and T Wälde (2008), 'Capital Transfers under Modern Investment Treaties', in Reinisch, op. cit., at 227–242.

2. *Obligation to permit the transfer of funds with exceptions and qualifications*

a. Open or closed list of transfers that must be permitted

Based on current practice, the items identified in provisions that set out a closed list of transfers permitted include most categories of transfers that are likely to be of interest to an investor. Nevertheless, a capital-exporting state is likely to prefer an open list to ensure that any new forms of financial flows are covered. An open list, however, reduces the certainty of its scope of application for states compared with a closed list.

The practice of making the commitment to permit funds transfer subject to domestic laws and regulations found in the COMESA Investment Agreement would seem to significantly reduce the benefit of the provision for investors. Defining the restriction by reference to domestic law in the host state renders it uncertain, non-transparent and subject to change. It does, however, give maximum flexibility to the host state.

b. Exceptions

As noted above, many IIAs contain detailed lists of situations in which restrictions are permitted, including the application of its laws in some or all of the specific areas identified in the summary.

These exceptions relate to areas of domestic policy that are not discriminatory and are addressed in most countries' laws, and they are increasingly found in IIAs. Most states impose these same restrictions on transfer. Their inclusion provides certainty regarding the situations in which host states may act to restrict transfers for the benefit of both parties.

Other exceptions in IIAs allow the restriction of payments by financial institutions in connection with prudential management to ensure the maintenance of the safety, soundness, integrity and financial responsibility of financial institutions and to address balance of payments emergencies. The last exception may be tied to compliance with the IMF Articles of Agreement to provide more certainty to investors. With respect to payments related to current transactions in goods and services, WTO members have committed to compliance with the IMF requirements under the *GATT* and the *GATS*. Alternatively, an exception may be drafted to be self-judging, meaning that it is up to the host state to decide in its discretion whether there is a balance of payments emergency or not. With such a provision, compliance with the requirements of the Articles of Agreement of the IMF would not be necessary.

If a transfer of funds obligation is included in an IIA, but is made subject to exceptions, it is possible that an unqualified obligation on a host state would be incorporated into an IIA if (i) the IIA contained an MFN clause and (ii) the state had entered into another IIA that included such an unqualified obligation. In these circumstances, the exceptions would not apply.

3. *Unqualified obligation to permit transfer of funds*

While this form of obligation appears in many treaties and provides the maximum protection to investors, it does not expressly permit various kinds of restrictions for legitimate policy purposes as described in relation to option 2. The only real issue to be addressed with such an obligation is whether there should be an open or closed list of permitted transfers.[271] This was discussed in relation to option 1.

5.8.3 Discussion of sample provision

While funds transfer provisions have not raised the same kinds of problems in investor–state arbitration as IIA provisions on expropriation and fair and equitable treatment, the drafting of funds transfer provisions could usefully incorporate some of the innovations from the IIA models reviewed. The sample provision has been drafted to ensure that it strikes a balance between investors' interest in being able to transfer funds out of the host state without restriction and the host state's interest in regulating transfers for the legitimate purposes of law enforcement, the regulation of financial institutions and the financial management of its economy.

Payments subject to funds transfer obligation: The sample definition of what payments are subject to the obligation to permit transfers is broad, but, in the interests of certainty, is fixed. While this is not the most common approach in IIAs, fixing the categories of payments is not likely to raise concerns for capital-exporting states and their investors because the provision covers most types of transfers likely to be of interest to investors. Since most agreements do not contemplate a right of establishment, the sample funds transfer provision does not extend to transfers *into* the host state. It applies only to transfers *out of* the host state. Where a funds transfer provision is used in an IIA that also creates a right of establishment, consideration should be given to whether the funds transfer obligation should be extended to inward transfers, subject to any limitations provided in the agreement.[272] The sample provision also provides that investors' home states may not require their investors to transfer funds, or penalise its investors that fail to transfer funds following the Canadian model. The sample provision goes on to clarify that this prohibition does not prevent a host state from restricting transfers where permitted by the exceptions discussed below.

Required currency for transfer: The sample provision adopts the approach of the Canadian model and many other agreements,[273] which provides that transfers are to be permitted in the currency originally used for the investment or any other currency agreed to by the parties. The use of 'freely usable currency', which may include only a small number of major developed country currencies, has not been adopted. Unless

271 To the extent that an IIA has an exception permitting the enforcement of measures to ensure compliance with laws and regulations that are not inconsistent with the provisions of the IIA, some of the exceptions listed in option 2 may be covered. Such an exception is discussed below. See Section 5.12 (Reservations and exceptions).

272 See above Section 5.2 (Right of establishment).

273 UK model IPPA, Art. 8; Indian model BIPPA, Art. 7(3) (no agreement of the parties required); Canadian model FIPA, Art. 14.2.

otherwise agreed by the investor and the state party concerned, payments are to be made at the market rate of exchange applicable on the date of transfer. If there was no market rate of exchange and the parties could not agree on another rate of exchange, the default is the rate of exchange applicable on the date of transfer pursuant to the exchange regulations in force in the host state. This approach follows the UK model.[274]

Exceptions for law enforcement: The sample provision incorporates the practical exceptions for measures to give effect to the application of laws in various areas that restrict transfers for different public policy reasons, reflecting those in the COMESA Investment Agreement, the ASEAN Agreement and the India–Singapore CECA, as well as the Canadian and US model treaties.[275] An exception for taxation measures could be added to the list or a general exception for taxation may be included in an IIA. Such a general exception for taxation is discussed below.[276]

Exceptions for prudential measures: The sample provision permits states to restrict the transfer of funds involving financial institutions in order to maintain the 'safety, soundness, integrity or financial responsibility of financial institutions' following the Canadian and other models. A broader general exception for prudential policies to protect depositors and others with a stake in financial institutions as well as the stability of the host state's financial system as a whole is provided for below.[277] This exception is included in the general exceptions section because host state actions driven by these considerations may not be limited to restrictions on the transfer of funds out of the country.

Exclusion for measures taken to address balance of payments emergency: The sample provision contains an exclusion for measures taken in a balance of payments emergency.[278] In IIAs that contain such a limitation, it is common practice to require that restrictions on transfers be temporary, in accordance with IMF standards, and made in good faith and on a non-discriminatory basis. These qualifications are intended to assure investors that restrictions for balance of payments purposes will be rarely used and will be fairly implemented. This means that in any case where a state seeks to take advantage of this exception to defeat an investor's claim the state's compliance with the requirements of IMF rules will be adjudicated by an investor–state tribunal. As noted, an alternative to avoid this possibility, it could simply be provided that it is

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274 An alternative default provision could be added, such as in the agreement between Brunei Darussalam and China (2000): '…in the event that the market rate of exchange does not exist, the rate of exchange shall correspond to the cross rate obtained from those rates which would be applied by the International Monetary Fund on the date of payment for conversions of the currencies concerned into Special Drawing Rights'.

275 US model BIT, Art. 7.1; Canadian model FIPA, Art. 14.1; India–Singapore CECA (2005), Art. 6.6(2); ASEAN Agreement (2009), Art. 13.3.

276 See Section 5.12 (Reservations and exceptions).

277 See Section 5.12 (Reservations and exceptions).

278 At a minimum, it might be useful to include an exception that permits restrictions in circumstances in which transfers may be restricted under other international agreements, such as in the exception in *GATT* Art. XII, which deals with balance of payments emergencies.

up to the state to determine if there is a balance of payments emergency and not refer to the IMF requirements.

5.8.4 Sample provision: free transfer of funds

Free Transfer of Funds

1. Each Party shall permit the following transfers relating to an investment of an investor of the other Party to be made freely and without delay out of its territory:
    a. Contributions to capital;
    b. Profits, dividends, interest, capital gains, royalty payments, management fees, technical assistance and other fees, returns in kind and other amounts derived from the investment;
    c. Proceeds from the sale of all or any part of the investment or from the partial or complete liquidation of the investment;
    d. Payments made under a contract entered into by the investor, or the investment, including payments made pursuant to a loan agreement;
    e. Remuneration to employees of the investor;
    f. Payments made pursuant to [Guide sample provision in Section 5.6 (Limitations on expropriation and nationalisation)] and [Guide sample provision in Section 5.7 (Compensation for losses)]; and
    g. Payments arising under [Guide sample provision in Section 7.1 (Investor–state dispute settlement)].
2. Each Party shall permit transfers relating to an investment of an investor of the other Party to be made in the currency in which the capital was originally invested, or in any other convertible currency agreed to by the investor and the Party concerned. Unless otherwise agreed to by the investor and the Party concerned, transfers shall be made at the market rate of exchange applicable on the date of transfer. If there is no such market rate or agreement, the rate shall be the rate of exchange applicable on the date of transfer pursuant to the exchange regulations in force in the Party.
3. Notwithstanding sections 1 and 2, a Party may prevent a transfer through the equitable, non-discriminatory and good faith application of its laws relating to:
    a. Bankruptcy, insolvency or the protection of the rights of creditors;
    b. Issuing, trading or dealing in securities;
    c. Criminal or penal offences and the payment of fines or penalties;
    d. Reports of transfers of currency or other monetary instruments;
    e. Ensuring the satisfaction of judgments in judicial or administrative proceedings;

f. Social security, public retirement and compulsory savings programmes; or

g. Payments of remuneration and severance to employees.

4. Neither Party may require its investors to transfer, or penalise its investors that fail to transfer, the income, earnings, profits or other amounts derived from or attributable to investments in the territory of the other Party.

5. Section 4 shall not be construed to prevent a Party from imposing any measure through the equitable, non-discriminatory and good faith application of its laws relating to the matters set out in subsections a. through g. of section 3.

6. Notwithstanding the provisions of sections 1, 2 and 4, and without limiting the applicability of sections 3 and 5, a Party may prevent or limit transfers by a financial institution to, or for the benefit of, an affiliate of or person related to such institution, through the equitable, non-discriminatory and good faith application of measures relating to maintenance of the safety, soundness, integrity or financial responsibility of financial institutions.

7. Notwithstanding section 1, in case of serious balance of payments difficulties or the threat of such difficulties, each Party may temporarily restrict transfers, provided that the Party's measures shall be consistent with the Article VIII of the Amended Articles of Agreement of the International Monetary Fund, in good faith and on a non-discriminatory basis.

5.9 Performance requirements

Cross references

Section 5.2 Right of establishment 104
Section 5.3 National treatment 110
Section 5.4 Most favoured nation 124
Section 5.12 Reservations and exceptions 224

Performance requirements are obligations that a state imposes on an investor to take some specific action with a view to achieving a domestic policy objective. In general, performance requirements seek to ensure that the potential benefits of foreign investment are realised. For example, an investor may be required to hire local workers or meet fixed targets for the volume of its exports. Performance requirements may be imposed by a state as a condition of permitting a foreign investor to bring its capital into the host state. They may also be imposed on an investor in relation to its ongoing operations, perhaps in exchange for some benefit such as a subsidy or tax break. Performance requirements are commonly used by many governments to ensure that their development goals are achieved.

Some commentators have criticised performance requirements as inherently redundant or inefficient. They argue that if it made business sense to do what was required by a performance requirement, the investor would do it without the performance requirement being imposed. Alternatively, if the investor would not have done what

the performance requirement obliges the investor to do, it is inefficient and costly to the investor. On this basis, it is argued that the costs associated with performance requirements could deter investors from investing.[279]

Performance requirements are addressed under rules binding on WTO members. These rules intersect with IIA commitments in sometimes complex ways. The WTO rules and IIA practice are discussed below.

5.9.1 Some performance requirements are prohibited by the WTO Agreement on Trade-related Investment Measures (*TRIMs*)

Some performance requirements for investors that affect trade in goods are inconsistent with obligations under the *GATT* that require WTO members to provide national treatment to foreign goods and not to impose quotas on foreign goods entering the country. In 1984, a *GATT* panel decision, in a case brought by the USA against Canada, found certain requirements imposed by Canada's Foreign Investment Review Agency as a condition of its approval of foreign investments to be contrary to *GATT*. For example, a requirement that foreign investors source their inputs in Canada in order to be allowed to invest in Canada was found to be contrary to Canada's obligations to give national treatment under the *GATT* because it imposed a preference for Canadian goods over foreign goods.[280]

The application of these *GATT* rules to performance requirements imposed in connection with investments was confirmed by the *TRIMs* Agreement, which provides an illustrative list of trade-distorting investment measures. It includes, for example, a prohibition on restricting the ability of an investor to import inputs for its local production in the host state. The full list of *TRIMs* is set out in Box 5.13.

Box 5.13 Illustrative list of Trade-related Investment Measures contrary to the *GATT* set out in the WTO *TRIMs* Agreement

1. *TRIMs* that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of *GATT* 1994 [national treatment] include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require:

    a. The purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production; or

(Continued)

279 UNCTAD (1998), *Bilateral Treaties in the Mid-1990s*, United Nations, Geneva.

280 World Trade Organization (WTO) (1984), *Canada – Administration of the Foreign Investment Review Act*, Report of the Panel adopted on 7 February 1984 (L/5504 – 30S/140), available at: www.wto.org/english/tratop_e/dispu_e/82fira.pdf (accessed 29 May 2012).

(Continued)

b. That an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports.

2. *TRIMs* that are inconsistent with the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of *GATT* 1994 [prohibition on quotas] include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which restrict:

a. The importation by an enterprise of products used in or related to its local production generally, or to an amount related to the volume or value of local production that it exports;

b. The importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise; or

c. The exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production.

As of 1 January 1995, WTO members have been subject to limitations on their ability to impose performance requirements that are inconsistent with the *TRIMs* Agreement.[281] For most WTO members, the imposition of performance requirements contrary to the *TRIMs* Agreement is prohibited. By virtue of a decision of the WTO Ministerial Conference in Hong Kong in 2005, however, least developed country members are excused from *TRIMs* obligations until 2020 in recognition of the possible development benefits associated with being able to impose such requirements.

5.9.2 Some performance requirements are prohibited by the WTO General Agreement on Trade in Services (*GATS*)

The obligations under the *TRIMs* Agreement apply only to trade in goods. It is possible, however, that some forms of performance requirements applied to investors in services sectors would be inconsistent with a country's commitments relating to

281 *TRIMs*' restrictions on the use of performance requirements apply only to measures that relate to trade in goods. The extent to which there are restrictions on measures relating to trade in services depends on a country's international obligations regarding trade in services. TRIMs' obligations were applied in *Indonesia – Certain Measures Affecting the Automobile Industry*, 2 July 1998, WT/DS54, 55, 59, 64/R.

services trade under the *GATS*. As noted above, some *GATS* obligations apply only to sectors that a country has listed in its national schedule of commitments.[282] For listed sectors, a WTO member cannot adopt specific kinds of limitations on market access and must provide national treatment to foreign services suppliers.[283] Some kinds of performance requirements may be prohibited by these obligations. For example, the imposition by a host state of requirements for an investor to use only domestic suppliers of construction services as a condition of granting approval for its investment to build a factory would probably be contrary to the *GATS* national treatment obligation if construction services were listed in the host state's national schedule of commitments. Some regional trade agreements also contain national treatment and other relevant obligations relating to performance requirements that could apply to services.

5.9.3 IIA practice

Although IIAs have not traditionally dealt with performance requirements, UNCTAD notes that restrictions on the use of performance requirements are increasingly found in more recent agreements.[284] Performance requirements may be imposed by states at two stages: (i) as a condition of admission of an investment; and (ii) in relation to the operation of an investment post admission. Performance requirement restrictions in IIAs address performance requirements at both stages.

Performance requirements as a condition of admission of an investment

A state may require investors to undertake certain actions as a condition of permitting them to invest in the country. Whether an IIA limits the ability of states to impose performance requirements as a condition of admission typically depends on whether the IIA creates a right for foreign investors of one party state to enter the market of the other party state and establish an investment. Rights of establishment were discussed above.[285] Where countries have undertaken no IIA obligation to permit the establishment of investments, they remain free to impose on investors whatever requirements they choose as a condition of permitting the entry of their investments into the local market, including performance requirements. The UK and Indian model agreements do not create a right of establishment and, consistently, do not impose restrictions on the ability of states to impose performance requirements as a condition of admission.[286] By contrast, where a state commits in an IIA to giving

282 See Section 3.3 (IIAs and other international obligations) and the overview of *GATS* obligations in Appendix 2.

283 The specific kinds of market access limitations that are prohibited, subject to any limitations on the market access obligation set out in a country's national schedule, are specifically listed in *GATS* Art. XIV. See the overview of *GATS* obligations in Appendix 2.

284 UNCTAD (2003), *World Investment Report 2003: FDI Policies for Development: National and International Perspectives*, United Nations, New York and Geneva, at 119–20.

285 See Section 5.2 (Right of establishment).

286 Indian model BIPPA; UK model IPPA. It may be that, in some cases, performance requirements imposed by states could be inconsistent with other IIA obligations, such as prohibitions on expropriation without compensation, the minimum standard of treatment and, if they are imposed in a discriminatory manner, national treatment and most favoured nation treatment.

foreign investors a right to establish themselves in the domestic market, the state implicitly gives up its right to impose performance requirements as a condition of access. In the Canadian and US model treaties, both of which provide a qualified right of establishment, express restrictions limit the ability of host states to impose performance requirements as a condition of permitting an investment to enter the market.[287]

Performance requirements related to the operation of an investment

Regardless of whether a right of establishment is provided for in an IIA, a state may impose performance requirements on foreign investors in relation to their activities in the host state after they bring their capital into the state, subject to any restrictions on the state's right to resort to performance requirements in the treaty. Both the US and Canadian model agreements restrict the ability of host states to impose performance requirements on investors after they are established in the market.[288] Most other IIAs do not impose specific restrictions on the use of performance requirements in this context.[289] Even without a specific provision dealing with performance requirements, however, any measure imposing performance requirements would have to be consistent with any other substantive standard in an IIA, including national treatment, MFN treatment and fair and equitable treatment.

Approaches to performance requirements provisions

A few treaties prohibit performance requirements in very general terms, but most recent treaties that address performance requirements contain detailed and specific provisions. Two main approaches are followed: (i) prohibiting performance requirements that are inconsistent with *TRIMs* and *GATS*; and (ii) prohibiting specific performance requirements, including performance requirements that are not inconsistent with *TRIMs* or *GATS*.

Incorporating TRIMs and GATS in an IIA

Some IIAs simply incorporate the obligations of the *TRIMs* Agreement, making them an obligation of the parties under the treaty. For example, the Canada–Costa Rica Foreign Investment Promotion and Protection Agreement contains the following clause relating to the *TRIMs* Agreement.

> Neither Contracting Party may impose, in connection with permitting the establishment or acquisition of an investment, or enforce in connection with the subsequent regulation of that investment, any of the requirements set forth in the World Trade Organization Agreement on Trade-related Investment Measures

287 Canadian model FIPA, Art. 7; US model BIT, Art. 8.

288 Canadian model FIPA, Art. 7; US model BIT, Art. 8.

289 For example, the India–Singapore CECA (2005) and the COMESA Investment Agreement (2007) do not prohibit performance requirements. In the India–Singapore CECA (2005), the parties reaffirm their commitments in this regard under the *TRIMS* Agreement (Art. 6.23).

> contained in the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, done at Marrakech on April 15, 1994.[290]

This provision does not address *GATS* obligations. Following the approach in the provision set out above, an IIA could, however, specifically recognise the binding nature of all WTO commitments and contemplate that the party states will commit not to impose performance requirements to the extent that their other international obligations prohibit doing so. Other commitments in regional agreements could be addressed as well.

Some IIAs contain an 'application of other rules' provision that binds the party states to comply with any other international obligation to which they are both parties relating to investments and to provide the benefit of any such obligation to investors protected under the IIA.[291] Under such a provision the obligations of the *TRIMs* Agreement and the *GATS* would apply as part of the IIA so long as the IIA parties were WTO members.

Every WTO member is bound by its obligations under *GATS* and the *TRIMs* Agreement. Reiterating these obligations in an IIA, however, changes the impact of these obligations in at least one important way: they become enforceable through the dispute settlement procedures in the IIA. This could be avoided by specifically excluding any performance requirement commitments from the scope of the dispute settlement procedures.

Detailed specification of prohibited performance requirements going beyond TRIMs *(*TRIMs *plus)*

In both the Canadian and US model agreements, the prohibition on the imposition of performance requirements applies to specific kinds of requirements set out in the agreement. This list includes some performance requirements that would be permitted under the *TRIMs* Agreement and *GATS*, such as commitments to transfer technology. For example, the Canadian model treaty provides that neither state party can:

> … impose or enforce any of the following commitments which relate to the *establishment*, *acquisition*, *expansion*, *management*, *conduct or operation* of an investment of an investor of a Party *or a non-Party*:

a. to export a given level or percentage of goods or services;

b. to achieve a given level or percentage of domestic content;

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290 Canada–Costa Rica, Agreement between the Government of Canada and the Government of the Republic of Costa Rica for the Promotion and Protection of Investments, signed 18 March 1998, in force 29 September 1999, Art. VI. A similar provision is found in the ASEAN–Australia–New Zealand FTA (2009) Investment Chapter, Art. 5. The IISD model treaty 'recognizes' the limits imposed by the *TRIMs* Agreement (Art. 26), but it is not clear if this amounts to an obligation not to put in place performance requirements inconsistent with *TRIMs*.

291 UNCTAD (2007), *Bilateral Investment Treaties 1995–2006*, op. cit., at 65–6 describing the Germany–Thailand BIT, Art. 7. The same provision is Art. 8 of the German model BIT.

c. to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from a person in its territory;

d. to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investments;

e. to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings; and

f. to transfer technology, a production process or other proprietary knowledge to a person in its territory, except where the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority, to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement; ...[292] (Emphasis added.)

A subset of these requirements may not be imposed by a host state as a condition of granting an advantage, such as a subsidy, to an investor. Because the obligation not to impose performance requirements relates to the 'establishment, acquisition, [and] expansion' of an investment, it applies to the pre-establishment stage. In other words, under this provision, a host state would not be able to impose any of these performance requirements on a foreign investor as a condition of allowing the investor into its market. The reference to 'management, conduct or operation' means that the host country is also prohibited from imposing any of these performance requirements on a foreign investor at the post-establishment stage in relation to these activities.[293] The performance requirement prohibition in this model extends to measures related to services as well as those related to goods.

In the performance requirement provision in the Canadian model agreement, all of these obligations also apply in relation to how party states deal with investors from *non-party states*. For example, under the Canadian model provision, a party state could not approve an investment by an investor from a third party state in return for its agreement to a performance requirement, such as a commitment to transfer technology. The provisions apply in this way in order to ensure that investors from the other state party to the IIA are not treated unfavourably compared with investors from third party states.[294] In the example above, if the prohibition did not extend to performance requirements imposed on investors from third party states, there would be a risk that Canada's foreign investment review agency would approve an investment from a third party state where the investor gave an undertaking to transfer technology, instead of approving an investment of an investor of a

292 Canadian model FIPA, Art. 7.

293 A similar approach is followed in treaties negotiated by Japan (UNCTAD (2007), *Treaties 1995–2006*, op. cit., at 67).

294 See the similar provision in the US model BIT. The Canadian model FIPA provides for limited specific exceptions to these obligations (Art. 9).

party state who could not be asked to make such a commitment because of the performance requirement prohibition in the treaty. This sort of provision seeks to ensure a level playing field for all investors. It is also found in the US model BIT, but not in other IIAs.[295]

Norway's draft model treaty contemplates a provision similar to the Canadian model, but contains some additional general requirements. It provides that any additional restrictions on a host state's resort to performance requirements should be negotiated taking into account both the specific needs of Norway's investors as well as any particular concerns of the host state. All performance requirements that are imposed must be transparent, non-discriminatory and applied in the public interest. The draft Norwegian model also contains a provision clarifying that the imposition of requirements to use a technology to meet general standards related to health, safety or the environment should not be subject to the prohibition on performance requirements.[296]

IIAs that have detailed performance requirements provisions such as those described above typically also include reservations taken by each party to preserve their right to impose performance requirements in some circumstances. General exceptions may also be relied on in some cases to permit measures that are performance requirements that would otherwise be prohibited under the treaty.[297] For example, an exception for measures to protect and promote the interests of indigenous peoples could permit a performance requirement that investors buy their inputs from indigenous peoples in the host state, subject to availability, even if requiring preferences in favour of inputs supplied by host state nationals is generally prohibited in an IIA.[298]

Affirming host state rights to impose performance requirements

The IISD model takes an entirely different approach from the IIAs described above. It expressly *permits* the use of performance requirements to ensure that development benefits flow from foreign investment. The IISD model gives host states the right to impose performance requirements on investors in order 'to promote domestic development benefits.'[299] The IISD model treaty 'recognises' the limits imposed by the *TRIMs* Agreement, but it is not clear to what extent this amounts to an obligation not to put in place performance requirements inconsistent with *TRIMs*.

295 This example is hypothetical because Canada always excludes its foreign investment review regime from the application of the performance requirement prohibition in IIAs that it negotiates.

296 Draft Norwegian APPI, Art. 8. In the India–Singapore CECA (2005), the parties do reaffirm their commitments in this regard under the *TRIMS* Agreement (Art. 6.23).

297 E.g. Canadian model FIPA, Art. 9. Canada routinely excludes performance requirements that are imposed in connection with approving foreign investments under its investment review law.

298 Such a requirement may be contrary to *TRIMs*.

299 IISD model treaty, Art. 26.

Box 5.14 Summary of options for performance requirements provisions

1. *Affirming a host state's right to impose performance requirements*
2. *No obligation regarding performance requirements*
3. *Prohibition on performance requirements inconsistent with TRIMs*
4. *Prohibition on specific TRIMs plus performance requirements*

5.9.4 Discussion of options

1. *Affirming a host state's right to impose performance requirements*

This kind of provision makes clear the party states' intention to allow the imposition of performance requirements. No treaty has adopted such a provision, but since it simply expressly recognises a right that states would have in the absence of any provision prohibiting the use of performance requirements, its inclusion may not be a significant concern for investors or capital-exporting states. The effect of such a provision, however, is not clear, and it has never been the subject of interpretation by an arbitral tribunal.

Even with such a provision, a host state would have to comply with its obligations under *TRIMs* as well as those under *GATS* if it is a WTO member but those obligations are not incorporated in the IIA and would probably not be enforceable under IIA dispute settlement procedures. Whether *GATS* and *TRIMs* obligations could be raised in IIA dispute settlement, however, would depend on the scope of those procedures as set out in the IIA. Some IIAs contain a clause that incorporates host state obligations that are not expressly provided for in the treaty.

Affirming a right to impose performance requirements does not seem to create an exception from other obligations in the IIA, so it would still be necessary for the host state to comply with other IIA obligations, including national treatment and MFN, in imposing performance requirements. The scope of application of these other IIA obligations will depend on the applicability of reservations and exceptions in the treaty.[300] Also, if the treaty does not apply to investments prior to admission then there is no limitation on the performance requirements that may be imposed by the host state as a condition of admission. The protection of the treaty simply does not apply to investments that have not been admitted.

A prohibition on the imposition of performance requirements could be incorporated into an IIA that does not contain a performance requirements provision if (i) the IIA contained an MFN clause and (ii) the state had entered into another IIA that included such a prohibition. An affirmation like the one in the IISD model may make it less likely that a prohibition on the imposition of performance requirements would

300 See Section 5.12 (Reservations and exceptions).

be incorporated into an IIA on this basis. Incorporating a prohibition through an MFN provision would contradict the parties' intention expressed in the affirmation.[301] Nevertheless in light of the inconsistent approaches of arbitral decisions in this area, there is a residual risk that a performance requirement prohibition could be incorporated through an MFN provision.

2. *No obligation regarding performance requirements*

This is the most common approach to dealing with performance requirements. A host state would still have to comply with its obligations under *TRIMs* and *GATS* if it is a WTO member. Without an express provision, these WTO obligations are not incorporated in the IIA and would be not enforceable under the agreement's dispute settlement procedures, though whether this is the right conclusion would depend on the scope of those procedures as discussed in relation to option 1. As noted, some treaties include a provision that all obligations undertaken by a party state may be the subject of the dispute resolution procedures in the treaty.[302] A host state would still have to comply with other IIA obligations, including national treatment and MFN, in imposing performance requirements, subject to any applicable reservations or exceptions. Treaty obligations would not limit the imposition of pre-establishment performance requirements if the treaty applies only to investments that have been admitted.

It is also possible that a prohibition on the imposition of performance requirements by a state would be incorporated into an IIA if (i) the IIA contained an MFN clause and (ii) the state had entered into another IIA that provided such an obligation.[303]

3. *Prohibition on performance requirements inconsistent with TRIMs*

A prohibition of this kind obliges IIA parties to comply with *TRIMs* obligations, which would apply in any case for WTO member states. It has the benefit of making this commitment transparent. Such a provision may be preferable to a host state that is a WTO member compared with the forms of provision in the Canadian and US model agreements because it does not contain rigid specific *TRIMs* plus prohibitions on the host state's ability to resort to performance requirements. Instead it incorporates in the IIA a host state obligation to comply with its existing international commitments. A host state would also have to comply with other IIA obligations, including national treatment and MFN, in imposing performance requirements, subject to any applicable reservations or exceptions. IIA obligations would not limit the imposition of pre-establishment performance requirements if the treaty applies only to investments that have been admitted.

Including such a provision in an IIA would probably render *TRIMs* obligations enforceable under the dispute settlement procedures of the IIA, though the procedures could be drafted to exclude these obligations. While it may be attractive

301 See Section 5.4 (Most favoured nation).

302 See the discussion of umbrella clauses in Section 7.1 (Investor–state arbitration).

303 See Section 5.4 (Most favoured nation).

to capital-exporting states and their investors to be able to enforce prohibitions on performance requirements through investor–state arbitration, there is no strong case for bolstering these WTO obligations in this way. Doing so might deprive host states in practice of the flexibility necessary to use performance requirements to meet their development objectives. The foregoing analysis would apply equally to a provision that prohibited performance requirements that were inconsistent with *GATS*.

It is also possible that a broader prohibition on the imposition of performance requirements by a host state would be incorporated into an IIA if (i) the IIA contained an MFN clause and (ii) the state had entered into another IIA that contained such an obligation.[304]

4. *Prohibition on specific TRIMs plus performance requirements*

This is the strongest form of obligation and imposes significant constraints on host states. It is found in treaties negotiated by Canada, the USA and Japan. Such a provision may be attractive to capital-exporting states because it provides investors with protection against the imposition by host states of specific kinds of performance requirements that go beyond what WTO members have committed to under *TRIMs* and *GATS*. A host state would also have to comply with other IIA obligations including national treatment and MFN in relation to all performance requirements subject to any applicable reservations or exceptions in the treaty. Treaty obligations regarding performance requirements would not limit the imposition of pre-establishment performance requirements if the treaty applies only to investments that have been admitted.

Including such a provision in an IIA would render the prohibition on performance requirements enforceable under the dispute settlement procedures of the IIA, though the scope of those procedures could be limited to preclude this result.

5.9.5 Summary

The Guide does not include a sample provision prohibiting performance requirements, even though resort to performance requirements by host states may deter investment in some cases. While some agreements, notably Canadian, US and Japanese agreements, prohibit performance requirements, most do not. In addition, prohibitions on performance requirements prevent host states from linking foreign investment to the needs of the local economy. For example, for many states, the transfer of technology constitutes one of the key benefits of foreign investment.[305] A prohibition on mandatory technology transfer requirements may jeopardise the prospects for realising this benefit. The prospect for performance requirements to play a role in promoting development has been recognised by the WTO.[306] The empirical evidence on the

304 See Section 5.4 (Most favoured nation).

305 UNCTAD (2003), op. cit., at 129. This is the right 'to enjoy the benefits of scientific progress and its applications' (ICESCR, Art. 15(1)(b)).

306 Ministerial Declaration on Doha Work Program, adopted at Hong Kong, 18 December 2005, Annex F (WT/MIN(05)/DEC).

effectiveness of performance requirements in enhancing development, however, is mixed.[307] Requirements to transfer technology, for example, may deter investors from using their technology in the host state. It has been noted that such research has focused primarily on the economic effectiveness of these measures. There has been little focus on the use and effectiveness of performance requirements to advance other social policy objectives.[308] It may be that a performance requirement for foreign investors to source their labour inputs from indigenous peoples in the host state, for example, is an effective way to promote their interests.

5.10 Transparency

Cross references

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To encourage investment by both foreign investors and domestic parties, an investment regime should be transparent and meet basic standards for fairness and due process in its administrative decision making and in the implementation of administrative policies. Transparency regarding the rules applicable to investments, as well as proposed legal and regulatory changes in the host country that might affect investments and high standards of fairness and due process for host state administration, produce a predictable environment in which foreign investors can make informed decisions with confidence regarding the legal requirements they must comply with and how they will be treated by the state. Investment may be encouraged as a result. Transparency regarding any incentives and other programmes that host states use to support investment, will directly contribute to effective investment promotion. Transparency regarding applicable rules also helps investors to ascertain whether they are being treated in accordance with those rules.[309] For all these reasons, IIA provisions requiring transparency and setting standards for government administration should facilitate and encourage inward foreign investment.

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307 UNCTAD (2003), *World Investment Report*, op. cit., at 120.

308 L E Peterson (2004), *Bilateral Investment Treaties and Development Policy Making*, Winnipeg, International Institute for Sustainable Development, at 34.

309 Transparency in dispute settlement proceedings is an important issue for investors and host states and is discussed in Section 7.1 (Investor–state dispute settlement) and Section 7.2 (State-to-state dispute settlement). Transparency and the exchange of information regarding home state policies and by investors are discussed below Section 8.1 (Investment promotion).

At the same time, increased transparency and improved administrative procedures are likely to have other benefits in terms of facilitating stakeholder participation in government, improving government accountability and reducing opportunities for corruption, all of which will contribute to a better, more efficient environment for both domestic and foreign businesses, as well as improved governance and sustainable development.

For some countries, however, greater transparency and improved administration may require a substantial and costly shift from traditional ways of operating. As these obligations become more specific and onerous, the costs will increase. For developing countries, these kinds of obligations are most likely to be effective when accompanied by IIA commitments from developed country parties to provide technical assistance to support the development of more transparent, fair and effective host state regimes.

In this section, the IIA practice regarding transparency and administrative procedure obligations is discussed. The transparency requirements emerging from some investor–state arbitration cases interpreting the fair and equitable treatment standard are also briefly surveyed.

5.10.1 IIA practice

Most recent IIAs deal with transparency issues in some fashion,[310] though some do not.[311] There is, however, some variation in the nature and scope of obligations regarding: (i) disclosure of the requirements of the existing legal regime; (ii) disclosure of proposed changes to the existing regime; and (iii) requirements that go beyond basic disclosure requirements to impose procedural and substantive standards for domestic administrative procedures.

Basic requirements regarding disclosure of the existing legal regime

Many agreements impose requirements on party states to disclose publicly the requirements of their existing legal regimes. For example, the US model BIT contains the following provision:

1. Each Party shall ensure that its

   a. *laws, regulations, procedures, administrative rulings of general application*; and

   b. *adjudicatory decisions*

   on matters covered by the Treaty are promptly published or otherwise made publicly available.[312] (Emphasis added.)

Similar obligations are imposed in the Canadian model agreement, as well as in the India–Singapore CECA, the ASEAN Agreement and the COMESA Investment

310 UNCTAD (2011), *Transparency in IIAs*, United Nations, New York and Geneva, at 114.
311 E.g. UK model IPPA; Indian model BIPPA; Colombian model agreement.
312 US model BIT, Art. 10.

Agreement.[313] The precise scope of the commitments varies. While strong commitments are optimal from the perspective of capital-exporting states and their investors, the burden on the host state will increase as provisions impose more onerous obligations. The variations in what is required are discussed below.

What categories of information have to be disclosed? In general, the obligation to publish laws and regulations will not be onerous for many countries. Such disclosure is typically required under domestic law. The publication of 'procedures, administrative rulings of general application; and … adjudicatory decisions', as in the US model, is a much more comprehensive obligation that imposes a heavier burden on host states. Adjudicatory decisions would include court, arbitration and administrative tribunal decisions. Some agreements impose more limited obligations. The ASEAN Agreement, for example, includes only 'laws, regulations and administrative guidelines of general application', excluding procedures and adjudicatory decisions. The India–Singapore CECA is similarly limited.[314] The ASEAN–Australia–New Zealand FTA Investment Chapter and some other IIAs create an obligation to disclose international agreements.[315]

What is the connection between the matters that are the subject of the disclosure obligation and the IIA that defines what has to be disclosed? In the US model, the disclosure obligation extends to 'all matters covered by the Treaty'.[316] In the COMESA Investment Agreement, disclosure is mandatory only in relation to 'measures' that pertain to or affect the agreement. Measures are defined as 'any legal administrative, judicial or policy decision that is taken by a member state, directly relating to and affecting an investment'.[317] Some other treaties adopt narrower approaches requiring a closer connection with the treaty obligations before disclosure is required. The Australia–US FTA applies only to measures that a party considers 'might materially affect the operation of the agreement or the other party's interests under this Agreement'.[318] Disclosing only measures that 'might materially affect' the operation of the agreement is a more limited commitment than that in the US model and would be easier to administer for host states.

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313 India–Singapore CECA (2005), Art. 6.15; ASEAN Agreement (2009), Art. 21; and COMESA Investment Agreement (2007), Art. 4. Similar provisions are also found in the Canadian model FIPA (Art. 19) and the draft Norwegian APPI (Art. 31).

314 The Canadian model FIPA does not refer to adjudicatory decisions. The ASEAN Agreement (2009) requires notification of such agreements to the council appointed under the agreement (Art. 21.1(a)).

315 ASEAN–Australia–New Zealand FTA (2009) Investment Chapter, Art. 13.1. See also ASEAN Agreement (2009), Art. 21.1(a).

316 The Canadian model FIPA uses the same language (Art. 19.1) and the India–Singapore CECA (2005) is similar (Art. 6.15(1)). In the ASEAN Agreement (2009), the comparable language is 'relevant laws that pertain to, or affect investments' (Art. 21(1)(c)). Perhaps the broadest obligation of all is the approach used in Azerbaijan–Estonia, Agreement between the Government of the Republic of Azerbaijan and the Government of the Republic of Estonia on the Promotion and Reciprocal Protection of Investments, signed 7 April 2010, not yet in force, which applies to all measures that 'may affect' investments (Art. 2.4).

317 COMESA Investment Agreement (2007), Art. 1.10.

318 Australia–United States Free Trade Agreement, signed 18 May 2004, in force 1 January 2005, Art. 20.3.

Are disclosure obligations mandatory? In the US model set out above, the obligation is mandatory. While a mandatory obligation is typical[319] in the Canadian model, a state need only disclose 'to the extent possible'.[320] The ASEAN–Australia–New Zealand FTA investment chapter creates a mandatory obligation, but creates an exception for emergency situations.[321]

Is disclosure combined with an obligation to respond to specific questions regarding matters covered by the IIA? In some models, the disclosure obligation is made more onerous because it is combined with an obligation to respond to specific questions from the other party state regarding matters covered by the IIA. For these IIAs, the administrative burden of compliance could be extensive.[322] The US model requires each state to provide information upon the request of the other party state regarding any actual or proposed measure that the requesting party state considers might materially affect the operation of this treaty.[323] Some IIAs require the establishment of contact points to be responsible for facilitating communication between the party states.[324] Contact points staffed by designated government officials facilitate not only disclosure of laws and policies, but also communication between the party states regarding investment issues. While contact points may encourage investment, establishing and maintaining a contact point involves the expenditure of resources to develop and maintain the necessary administrative and technical capacity to operate it.

Some of these kinds of basic disclosure obligations are imposed on WTO members under *GATS*. The obligations in *GATS* are set out in Box 5.15.

Box 5.15 Transparency obligations in *GATS*

Some of the transparency requirements in IIA models can be found in the *GATS* and other WTO Agreements.

Article III of *GATS* requires WTO members to publish promptly all relevant measures of general application that pertain to, or would affect the operation of,

(Continued)

319 India–Singapore CECA (2005), Art. 6.15; and COMESA Investment Agreement (2007), Art. 4.

320 Canadian model FIPA, Art. 19.1. The Azerbaijan–Estonia BIT (2010) uses the same language (Art. 2.4).

321 ASEAN–Australia–New Zealand FTA (2009) Investment Chapter, Art. 13.1. This agreement also contemplates that publication be prompt and on the internet but, if that is not practicable, then some other way of making the information public shall be found (Arts. 13.2, 13.3).

322 India–Singapore CECA (2005), Art. 6.15(2); Japan–Peru, Agreement between Japan and the Republic of Peru for the Promotion, Protection and Liberalisation of Investment, signed 22 November 2008, in force 10 December 2009, Art. 9.

323 Canadian model FIPA, Art. 19; US model BIT, Art. 11.5.

324 United States–Rwanda, Treaty between the Government of the United States of America and the Government of the Republic of Rwanda concerning the Encouragement and Reciprocal Protection of Investment, signed 19 February 2008, in force 1 January 2012, Art. 11.1; ASEAN–Australia–New Zealand FTA (2009) Investment Chapter, Art. 13.1; ASEAN Agreement (2009), Art. 21.

(Continued)

GATS. 'Measures' is defined as 'any measure by a member, whether in the form of a law, regulation, rule, procedure, decision, administrative action or any other form'. Bilateral or plurilateral agreements on services must also be published (Article XXVII). Since *GATS* applies to 'commercial presence', its obligations extend to some investments in services.[325]

WTO members are also obliged to respond to requests for information regarding their measures and agreements. There are enhanced transparency obligations for sectors in relation to which a member has undertaken specific commitments, which means that the member has listed the sector in the member's national schedule of commitments. In addition to the general publication obligation, each member must establish one or more enquiry points to provide specific information to other members regarding its services regime. *GATS* does not oblige members to disclose confidential information the publication of which would impede law enforcement or otherwise conflict with the public interest, or which would prejudice legitimate commercial interests.[326]

In relation to services, all WTO members have to comply with these obligations regardless of what is provided for in any IIA to which they are a party.

Disclosure of proposed measures

In addition to disclosure regarding the existing regime, many treaties require some disclosure in relation to proposed measures.[327] The disclosure of draft or proposed measures by the host state is often considered important to investors in order to help them avoid unexpected changes in the host state's regulatory framework. Commitments to disclose proposed measures and provide affected investors with an opportunity to comment provides a level of assurance for foreign investors that their interests are being taken into account. Provisions that permit interested persons to comment on proposed measures also promote participation by domestic stakeholders in the process of developing host state rules.

The Canadian and US models require that any measure that a party proposes to adopt that applies to matters covered by the treaty should be published in advance and 'interested persons' as well as the other party state itself must be permitted to

325 See Section 3.3 (IIAs and other international obligations) Box 3.1.

326 A similar proviso regarding confidential information is contained in the India–Singapore CECA (Art. 6.14(2)), the ASEAN Agreement (Art. 21.2) and the COMESA Investment Agreement (Art. 4.4).

327 E.g. India–Singapore CECA (2005), Art. 6.15.

comment on the proposed measure.[328] The US and Canadian models define the range of proposed measures to be disclosed in the same way as for the basic disclosure obligation discussed above. Treaties that require disclosure of proposed measures reduce the burden of this obligation on host states in different ways.

- **Some IIAs limit the scope of what must be disclosed**. For example, the Canada–Panama FTA limits the obligation to measures that 'might materially affect the operation of the agreement or substantially affect the other party's interests' under the agreement.[329]
- **Some IIAs limit the disclosure obligation to what is required by the host state's domestic law.** The ASEAN–Australia–New Zealand FTA investment chapter provides that each party 'shall endeavour to provide a reasonable opportunity for comments by interested parties prior to measures that are subject of the basic disclosure obligation' but only '[t]o the extent provided for under its domestic legal framework'.
- **Disclosure is required only to the extent possible.** In both the US and Canadian models, in recognition of the more burdensome nature of the obligation to disclose proposed measures, the obligation obliges states to disclose only 'to the extent possible.[330]
- **Some IIAs require only that new measures be disclosed after they have been implemented.** The COMESA Investment Agreement does not require notice of a proposed change at all. Instead it requires member states to inform the public of any new measure or change to an existing measure that affects investments or the party's commitments under the agreement within 30 days of its enactment.[331] The ASEAN Agreement requires simply that new or changed laws that 'significantly affect investments or commitments of a member' be notified to the council created under the agreement.[332]

Consultation, exchange of information and co-operation

In addition to disclosure obligations, some treaties impose additional obligations regarding transparency. Some impose an obligation on each party state to consult with the other on request regarding any question related to the interpretation or

328 Canadian model FIPA, Art. 19.1; US model BIT, Art. 11.2. The US model goes on to impose a much more specific set of requirements regarding how central government regulations are to be published.

329 Canada–Panama Free Trade Agreement, signed 14 May 2010, not yet in force, Art. 20.03.

330 Canadian model FIPA, Art. 19.1; US model BIT, Art. 11.2. The same language is used in NAFTA (1992), Art. 1802 and China–New Zealand Free Trade Agreement, signed 7 April 2008, not yet in force, Chapter 13.

331 COMESA Investment Agreement (2007), Art. 4.3.

332 ASEAN Agreement (2009), Art. 21(b).

application of the IIA.[333] In addition, some treaties provide that upon the request by either party, 'information shall be exchanged on the foreign investment policies, laws and regulations of the other Contracting Party that may have an impact on new investments or returns covered by this Agreement'.[334] This kind of exchange is one way to facilitate the dissemination of information regarding the host state's regime and the opportunities and incentives it provides to foreign investors. Finally, some IIAs create a general obligation on the parties to co-operate on promoting transparency in relation to international trade and investment.[335]

Exceptions

Many IIAs contain exceptions that allow state parties not to disclose confidential information concerning particular investors or investments where disclosure would impede law enforcement, or otherwise be contrary to the public interest, or which would prejudice legitimate commercial interests of particular legal persons, public or private. Sometimes these exceptions are set out in transparency provisions.[336] In other IIAs, they are included in the general exceptions provisions. The Canadian model agreement, for example, creates a general exception for all obligations under the agreement for measures to protect confidential information.[337]

Who bears the transparency obligation?

Typical transparency obligations are expressed to apply to both states equally.[338] In practice, in most cases, it is capital-importing states that will need to bear the obligation in mind. Capital-exporting states and their investors will insist on compliance with transparency obligations. Capital-importing states may also be encouraged to comply in the hope of attracting investors. Some treaties expressly recognise the greater practical relevance of the transparency obligations to host states by describing the obligation as relating to measures of a party that may affect the investment of investors of the other party in its territory.[339]

Where a treaty contains obligations that go beyond investor protection by host states, however, transparency obligations in relation to investors' home states may be relevant. For example, if home states are obliged to co-operate with host states to address investor violations of IIA provisions or host state domestic rules relating to corruption or breaches of human rights, labour rights or indigenous rights obligations, then disclosure of relevant measures of the home state could become

333 E.g. Thailand–Jordan, Agreement between the Government of the Kingdom of Thailand and the Government of the Hashemite Kingdom of Jordan for the Promotion and Protection of Investments, signed 15 December 2005, not yet in force, Art. 9. The US model BIT provides that the parties are to consult periodically on ways to improve the transparency practices.

334 E.g. Thailand–Jordan BIT (2005), Art. 9.

335 E.g. Canada–Peru FTA (2008), Art. 1905.

336 COMESA Investment Agreement (2007), Art. 4.4.

337 Canadian model FIPA, Art. 11.5. See Section 5.12 (Reservations and exceptions) for an example.

338 E.g. Canadian model FIPA, Art. 19.1; US model BIT, Art. 11.2.

339 E.g. Azerbaijan–Estonia BIT (2010), Art. 2.

important.[340] Obligations of this kind are discussed below.[341] Similarly, if home states have investment promotion or technical assistance obligations, transparency commitments regarding the steps they have taken to fulfil these obligations may be relevant.[342] Consideration may also be given to the desirability of transparency obligations on investors and provisions enabling host states to require disclosure from investors.

Requirements for administrative procedures

A few IIAs seek to provide procedural protections for the benefit of individual investors in their dealings with party states. For example, the US model BIT goes beyond basic transparency commitments to require parties to provide certain protections for investors in administrative proceedings, including a right for an investor to receive reasonable notice of any proceeding that directly affects its interests and a reasonable opportunity to present facts and arguments at such a proceeding. Compliance with any requirements of domestic law is also required. Such rights are to be accorded 'wherever possible'. Party states are also required to have judicial and administrative tribunals for the purpose of providing prompt review of decisions relating to matters arising under the treaty.[343]

In addition to these procedural protections, the US model agreement sets out some general substantive standards that host state procedures should achieve. Tribunals reviewing administrative decisions must be impartial and independent of the agency responsible for enforcement and must not have any interest in the outcome of the matter. Persons participating in these reviews must have a reasonable opportunity to defend their positions, and decisions must be based on evidence and submissions.[344]

The IISD model treaty contains a provision on 'procedural fairness' that similarly combines procedural requirements for host state administrative actions with substantive standards. In some respects, the standards in the IISD model go beyond those in the US model. Under the IISD model, the parties must deal with investors in a manner that is not arbitrary or unfair and does not constitute a denial of justice. The IISD commitments also extend to judicial and legislative processes, as well as administrative procedures. To balance these far-reaching requirements, however, the IISD model recognises that there is no single international standard for achieving these objectives and acknowledges that there may be differences from one country to another depending on the level of development. In terms of specific process requirements, the IISD model follows the US model in requiring timely notice to investors of proceedings directly relating to them, and investor access to review or appeal procedures. The IISD model also requires that judicial and administrative proceedings be open to the public.

340 Some agreements also permit states to seek information from investors. Such a right will be more important where investors have obligations.

341 See Section 6.13 (Enforcement of investor obligations).

342 See Chapter 8 (Investment Promotion and Technical Assistance).

343 US model BIT, Arts. 11.6 and 11.7.

344 US model BIT, Arts. 11.4 and 11.5. A similar approach is taken in the ASEAN–Australia–New Zealand FTA (2009) Investment Chapter, Art. 14.

5.10.2 Transparency obligations deriving from FET

A number of investor–state arbitration awards have described transparency as an element of the fair and equitable treatment obligation. In *Tecmed v. Mexico*, for example, the tribunal described the FET obligation as requiring the following:

> The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.[345]

This approach has been applied in other cases.[346] It has also been criticised as setting an unreasonably high standard[347] that few states could meet and one that would be especially burdensome for developing countries.[348] Many cases have imposed standards for administrative procedures on host states under the FET standard.[349]

Box 5.16 Summary of options for transparency provisions

1. *No transparency obligation*
2. *Transparency obligation with a basic commitment to disclose existing and proposed laws*

   The main issue with this kind of obligation is the scope of the disclosure obligation. Existing IIAs require disclosure of some combination of the following kinds of measures:

   a. Existing laws and regulations, administrative procedures and rulings, judicial decisions, and international agreements;

   b. Draft or proposed laws and regulations (which may be combined with an obligation to provide an opportunity to comment on proposed laws and regulations).

   There is also some variation in IIA provisions regarding the connection that is required between the measure and investment in order to trigger the disclosure obligation. Obligations may attach to measures that:

(Continued)

345 *Tecmed v. Mexico*, op. cit.

346 *Azurix Corp. v. Republic of Argentina*, ICSID Case No. ARB/01/12, Award, 14 July 2006, at paras. 371–3; and *Lemire v. Ukraine*, ICSID Case No. ARB/06/18, IIC 424 (2010), Decision on Jurisdiction and Liability, 14 January 2010.

347 UNCTAD (2011), *Transparency*, op. cit., at 61. See also R Dolzer (2006), 'The Impact of International Investment Treaties on Domestic Administrative Law', 37 *NYU Journal of International Law and Politics* 953.

348 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).

349 Ibid.

(Continued)

a. May affect investments;

b. Affect investments;

c. Substantially affect, materially affect or significantly affect investments.

In addition, treaty practice sets different standards with respect to whether the obligation is mandatory or only 'to the extent possible'.

Some treaties create an obligation to respond to specific questions on matters related to the treaty and establish a contact point to provide information regarding the host state's domestic regime.

3. *Obligations regarding consultation and co-operation*

Some agreements provide obligations for states to:

a. Consult on any question related to the interpretation or application of the IIA;

b. Exchange information on the foreign investment policies, laws and regulations of the other party that may have an impact on new investments or returns covered by the agreement; and

c. Co-operate in promoting transparency in respect of international trade and investment.

4. *Transparency obligation with additional specific commitments regarding domestic administrative procedures*

5.10.3 Discussion of options

1. *No transparency obligation*

Not all IIAs include a commitment regarding transparency. Some capital-exporting states, however, such as Canada and the USA, routinely seek commitments regarding transparency. In addition, there are benefits associated with transparency for host states in terms of improved governance and investment promotion. A commitment to transparency would provide assurances to investors of predictability in the host state's regime that might attract them. At the same time, a state considering a specific transparency commitment would have to consider the costs involved.

Even without a specific transparency obligation, a state would still have to comply with any other obligation in the IIA that imposes requirements related to transparency. Depending on the formulation of an FET obligation in an IIA and its interpretation by an investor–state tribunal, an FET obligation may impose transparency requirements.[350] It is also possible that a transparency obligation would

350 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).

be incorporated into an IIA that contained an MFN clause if the state had entered into another IIA that provided such an obligation.[351]

2. *Transparency obligation with a basic commitment to disclose existing and proposed laws*

As noted, the main issue with this kind of obligation is its scope. From the perspective of an investor and its home state, more comprehensive and binding transparency obligations will be preferable. Host states will benefit from transparency commitments to the extent that they encourage investment, but must also consider the burden of transparency requirements. The obligation to disclose only laws and regulations is the least intrusive and may already be required under domestic law. A commitment to disclose administrative procedures and rulings, judicial decisions, international agreements and, especially, proposed laws and regulations may require significant changes to government operations and new resources. An obligation to establish an enquiry point is likely to be the most resource-intensive commitment.

The effective scope of the obligation is also affected by the degree of connection required between the measures that must be disclosed and investments. Disclosure of laws and so on that 'may affect' is a very high standard. Sometimes it may be hard to tell if a measure 'may affect' matters related to the treaty. By contrast, it is easier to tell if a measure actually affects or substantially, materially or significantly affects such matters. There may be some slight difference in the degree of obligation created by these last three expressions, but all require more than a trivial effect. The obligation is also mitigated if it is qualified by language such as 'to the extent possible'.

It is possible to establish differing degrees of obligation for existing and proposed measures. Some states commit to providing disclosure of existing measures and only after the fact disclosure for changes to measures and new measures. Exceptions to transparency commitments to permit states not to disclose confidential information are common. The impact of transparency commitments could also be limited by exempting them from the application of dispute settlement procedures. Basic transparency obligations are not intended to directly benefit individual investors, and so it may be appropriate to exclude them from obligations that could be the basis for an investor–state claim.

Regardless of what is specifically provided for in an IIA, it is possible that minimum requirements in this regard will be established by an FET obligation in an IIA.

3. *Obligations regarding consultation and co-operation*

In principle, these kinds of obligations may be included in an IIA whether or not there is a basic obligation to disclose the existing law in an area. Consultation and co-operation obligations may not be viewed as onerous. Consultation and co-operation are soft obligations that do not involve specific commitments to do a great deal. In addition, it is likely to be in each state's interest to be able to talk to the other about investment policy issues and find out about each other's policies regarding inward

351 See Section 5.4 (Most favoured nation).

and outward investment. Exchanging information regarding a host state's investment regime, including any incentives or opportunities provided, may help to promote investment.

4. *Transparency obligation with additional specific commitments regarding domestic administrative procedures*

States that already have robust domestic administrative procedures in place may be willing to undertake this more onerous set of obligations to send a strong signal to investors regarding their commitment to fairness and due process, as in the US model agreement. More robust domestic regimes that meet such standards for administrative procedures are more likely to produce sustainable development, and commitments to such standards will be attractive to investors. Consequently, states whose domestic regimes meet these standards may decide to commit to maintaining them. Other host states may not be in a position to undertake such commitments. It is possible to qualify the burden of these obligations by adding a provision such as appears in the IISD model, requiring these obligations to be interpreted in light of the level of development of the host country.

The impact of such commitments could be limited in practice by exempting them from the application of IIA dispute settlement procedures. Obligations regarding administrative procedures have a general benefit for investors, but may be relevant to the treatment of an individual investor too. Consequently, the argument for excluding such obligations from those that may be the basis of an investor–state claim is not as strong as for excluding basic transparency obligations, as discussed in option 2.

Depending on the formulation of any FET obligation and its interpretation by an investor–state tribunal, a state may have obligations related to the conduct of its administrative procedures arising out of the FET obligation.[352]

With respect to any of options 2, 3 or 4, it is possible that any more favourable obligation with respect to transparency or administrative procedures that a state has entered into in another IIA would be incorporated into an IIA that contained an MFN clause.[353]

5.10.4 Discussion of sample provision

The Guide provides a sample of a basic provision committing host states to transparency, with a view to encouraging investment and improving the quality and effectiveness of domestic regulation. It has the following elements.

Obligation on each party state to publish existing laws, regulations, procedures, administrative rulings of general application and any international agreement to which it is a party relating to any matter covered by the investment agreement: Such an obligation is found in many current IIAs. In addition, the Guide provision mirrors the commitments undertaken by all WTO members in GATS Article III. In

352 See Section 5.5 (Fair and equitable treatment and the minimum standard of treatment).
353 See Section 5.4 (Most favoured nation).

order to limit the burden of this obligation, the Guide provision obliges states to meet these requirements only 'to the extent possible' as in the Canadian model agreement, which provides some flexibility for host states.

Publication of proposed laws with a right to comment: The sample also creates an obligation to publish and provide an opportunity to comment on any new laws and regulations that the host state proposes to adopt relating to any matter covered by the investment agreement. Such a commitment is important to investors, contributes to good governance and appears in some IIAs. Nevertheless, such a commitment may not be feasible for states where it would require significant changes to government operations and new resources. In order to limit the burden of these obligations, the Guide provision obliges states to meet these requirements only 'to the extent possible'.

Exchange of information: The Guide includes a sample provision that creates obligations regarding the exchange of information between parties related to measures that may have a material impact on investment. In light of the possible concerns regarding the resource implications of such a commitment for host states, the Guide does not create a specific requirement for host states to establish a contact point for party states or investors seeking information on the domestic regime. However, putting in place a contact point may be valuable and appropriate for some states and, as noted, is required under *GATS* in some cases. The role of information exchange and enquiry points in promoting investment is discussed further below.[354] A consultation obligation is also included in relation to any actual or proposed measure or any other matter that a party state considers might materially affect the operation of the agreement.

No obligation to disclose confidential information: Many IIAs contain exceptions that allow party states not to disclose confidential information concerning particular investors or investments where disclosure would impede law enforcement or otherwise be contrary to the public interest, or which would prejudice legitimate commercial interests of particular legal persons, public or private. Sometimes these exceptions are set out in transparency provisions.[355] The sample provision provides an example of this. In other IIAs, they are included in general exceptions provisions.[356]

The obligations in the sample provision apply to all party states. In part, this approach, which is followed in most IIAs, recognises that there may be disclosure that should be required of the investor's home state to the extent that obligations of home states are included in an IIA. The Guide describes some possible home state obligations below.[357]

No obligation regarding administrative procedures: The willingness of developing countries to accept these kinds of commitments will depend not only on the level of development of their administrative systems, but also on the prospects for receiving

354 See Section 8.1 (Investment promotion).

355 COMESA Investment Agreement (2007), Art. 4.4.

356 E.g. Canadian model FIPA, Art. 11.5. The Canadian model agreement extends the exception to confidential information generally. See Section 5.12 (Reservations and exceptions) for an example.

357 See Section 6.13 (Enforcement of investor obligations) and Section 8.2 (Technical assistance).

technical assistance from developed country parties to support the development of such systems. Technical assistance provisions are provided for elsewhere in the Guide.[358]

5.10.5 Sample provision: transparency

Transparency

1. Each Party shall, to the extent possible, ensure that its laws, regulations, procedures, administrative rulings of general application and any international agreement to which it is a party respecting any matter covered by this agreement are published or otherwise made available in such a manner as to enable interested persons and the other Party to become acquainted with them.
2. To the extent possible, each Party shall:
    a. Publish in advance any law or regulation respecting any matter covered by this agreement that it proposes to adopt; and
    b. Provide interested persons and the other Party with a reasonable opportunity to comment on such proposed measures.
3. Upon request by a Party, information shall be exchanged on the measures of the other Party that may have a material impact on investments subject to this agreement.
4. A Party may request in writing consultations with the other Party regarding any actual or proposed measure or any other matter that it considers might materially affect the operation of this agreement. The other Party shall engage in consultations within 30 days of such request.
5. Nothing in this agreement shall require a Party to furnish or allow access to any confidential information, including information concerning particular investors or investments, the disclosure of which would impede law enforcement, or otherwise be contrary to the public interest, or which would prejudice legitimate commercial interests of particular legal persons, public or private.

5.11 Entry and sojourn of foreign nationals and restrictions on nationality requirements for senior management

Cross reference

Section 5.4 Most favoured nation 124

The effective operation of a foreign investment may require employees of the investor with high-level management authority or special skills to be able to work on a temporary basis in the host country. Nevertheless, few IIAs create any meaningful

358 See Section 8.2 (Technical assistance).

commitments with respect to the entry of foreign personnel into host states because of labour market, immigration and security concerns.[359]

Another issue related to foreign personnel is nationality requirements for senior managers. Host states often have an interest in ensuring that their nationals fill senior positions or particular technical specialist positions in foreign investment operations. Host states may view access to this type of position as a way to ensure that nationals get both technical training and management expertise. The benefits to individual nationals can spill over as they transfer their experience to others in the host state. Some states have rules that require that certain positions be held by nationals in the hope of capturing these benefits of foreign investment. Investors typically do not like this kind of rule because they want to be able to hire whoever they believe is best for the job regardless of nationality, including, often, their own nationals. Some IIA provisions limit the ability of host states to impose nationality requirements.

5.11.1 IIA practice

Entry and sojourn of foreign nationals

While most IIAs contain no commitments regarding the entry of foreign nationals, a few provide very limited commitments. For example, some agreements oblige a host state to give assistance to nationals from another party that are seeking permission to engage in activities associated with an investment in the host state.[360] Other IIAs commit host states to give sympathetic consideration to requests for permission to enter in these circumstances.[361] Another variant is agreements that do not create a right of entry, but commit the host state not to apply labour market tests based on the economic need for workers or numerical quotas for workers in relation to employees of investors from the other party state.[362]

The Indian model treaty does contain a commitment on the part of each state to permit non-citizens to enter the host state for the purpose of engaging in activities connected with investment, but only subject to the state's own laws applicable to entry requirements from time to time.[363] This caveat would seem to remove any

359 Neither the US model BIT nor the UK model IPPA addresses entry of personnel.

360 Botswana–China, Agreement between the Government of the Republic of Botswana and the Government of the People's Republic of China on Promotion and Protection of Investments, signed 12 June 2000, not yet in force, Art. 2.

361 France–Mexico, Agreement between the Government of the Republic of France and the Government of the United Mexican States on the Reciprocal Promotion and Protection of Investments, signed 12 November 1998, in force 12 November 2000, Art. 4.

362 United States–Nicaragua, Treaty between the Government of the United States of America and the Government of the Republic of Nicaragua concerning the Encouragement and Reciprocal Protection of Investment, signed 1 July 2005, not yet in force, Art. VII. See also Japan–Korea BIT (2003), Art. 8. This agreement allows for such tests to be applied after prior notification and consultation with the other party.

363 Indian model BIPPA, Art.11; Australia–India BIT. There are similar commitments in the US–Nicaragua BIT (Art. VII) and the Japan–Korea BIT (Art. 8), but they are limited to nationals of the other party who enter for the purpose of establishing, developing, administering or advising on the operation of an investment to which they, or a company of the other party that employs them, have committed or are in the process of committing a substantial amount of capital or other resources.

real binding effect from this provision. Similarly, the Canadian model obliges each party state to permit temporary entry of nationals of another party state that is the investor's home state to render services to the investor's investment in a capacity that is managerial or executive or that requires special knowledge, but only subject to the 'laws, regulations and policies of the host state'.[364] The Canadian provision is set out in Box 5.17. The COMESA Investment Agreement requires member states to permit investors to hire technically qualified persons from any country, but obliges investors to give priority to workers with the same qualifications in the host state.[365]

Box 5.17 Canadian model FIPA provision on entry of foreign nationals and restrictions on nationality requirements for senior management

Article 6

Senior Management, Boards of Directors and Entry of Personnel

1. A Party may not require that an enterprise of that Party, that is a covered investment, appoint to senior management positions individuals of any particular nationality.
2. A Party may require that a majority of the board of directors, or any committee thereof, of an enterprise that is a covered investment be of a particular nationality, or resident in the territory of the Party, provided that the requirement does not materially impair the ability of the investor to exercise control over its investment.
3. Subject to its laws, regulations and policies relating to the entry of aliens, each Party shall grant temporary entry to nationals of the other Party, employed by an investor of the other Party, who seeks to render services to an investment of that investor in the territory of the Party, in a capacity that is managerial or executive or requires specialised knowledge.

Restrictions on nationality requirements for senior management

Some IIAs limit the ability of host states to require that their own nationals occupy identified positions with businesses operated by foreign investors, though most do not address this issue. For example, a few IIAs provide that party states cannot require that senior management positions in the local operation of foreign investors of the other party state be held by persons of any particular nationality, including the nationality of the host state. Such provisions ensure that a foreign investor has freedom to choose who runs its investment. However, because this obligation imposes no requirement on party

364 Canadian model FIPA, Art. 6.3. The IISD model treaty is similar (Art. 9C) as is the Norwegian draft model IPPA (Art. 4.2.8) and the ASEAN Agreement (2009) (Art. 22).

365 COMESA Investment Agreement (2007), Art. 16. This would appear to mean that a host state can require that such priority be given. The COMESA Investment Agreement (2007) is part of a regional integration project and its provisions probably reflect that distinct goal.

states to admit foreign nationals into their territory, in practice investors will be limited in terms of whom they can choose as senior managers working in the host state. Only nationals and foreigners admitted in accordance with host state law will be eligible.

IIAs take several approaches to prohibitions on host state nationality requirements for senior managers. The Australia–Egypt BIT provides that each party shall permit investors of the other party to employ within its territory key technical and managerial personnel of their choice regardless of citizenship. In this agreement, the commitment is made subject to host state law, which would appear to eliminate the effective benefit of the commitments, since provisions in host state law could impose limitations or even an outright ban.[366] The US–Lithuania BIT contains the same obligation, but without this limitation.[367] The Canadian and US model treaties contain another version of such a provision. The general prohibition on nationality requirements is narrowed by an exception permitting host state requirements that a majority of the board of directors of an investment have a particular nationality or residence, so long as the requirement 'does not materially impair the ability of the investor to exercise control over its investment'.[368] Canada's provision is set out in Box 5.17.

The *GATS* and some other trade agreements contain provisions on the temporary entry of individuals, including NAFTA[369] and the EC–CARIFORUM economic partnership agreement (EPA). These obligations would have to be complied with by party states regardless of any other commitments in an IIA. *GATS* commitments are described in Box 5.18.

Box 5.18 *GATS* and the entry of foreign nationals and restrictions on nationality requirements for senior management

The obligations of the General Agreement on Trade in Services[370] apply to the supply of services by individuals, though the obligations are very limited. *GATS* obligations do not apply to natural persons seeking access to the employment market in a member state or measures regarding citizenship, residence or employment

(Continued)

366 Australia–Egypt, Agreement between the Government of Australia and the Government of the Arab Republic of Egypt on the Promotion and Protection of Investments, signed 3 May 2001, in force 5 September 2002, Art. 5.

367 United States–Lithuania, Treaty between the Government of the United States of America and the Government of the Republic of Lithuania for the Encouragement and Reciprocal Protection of Investment, signed 14 January 1998, in force 22 November 2001, Art. II.

368 Canadian model FIPA, Art. 6; US model BIT, Art. 9. See also the India–Singapore CECA (2005) (Art. 6.19(2)) and IISD model treaty (Art. 9). This qualification reflects requirements of domestic corporate law in Canada and some other jurisdictions.

369 NAFTA (1992) Chapter 16 commits each NAFTA party to grant temporary entry on specified terms for a number of categories of individuals including investors and intra-corporate transferees who are managers or have some specialized knowledge and who are employees of an investor of another party seeking to provide services to an investment of that investor in the first party. The EC–CARIFORUM EPA (2008) deals with temporary entry in Arts. 80–4.

370 See Appendix 2 of the Guide for an overview of *GATS*.

(Continued)

on a permanent basis. Members are also permitted to apply measures to regulate entry, such as visas. However, each member can make commitments in its national schedule of commitments relating to the movement of natural persons. Many developed countries but few developing countries did so.[371] A WTO member who has made commitments in its national schedule is obliged under *GATS* to provide the access agreed to in relation to services suppliers of other WTO members.

Members who made commitments typically grant rights of temporary entry into their territory for specific categories of persons who have technical or managerial expertise subject to requirements set out in their national schedules. In its national schedule, for example, Canada committed to granting temporary entry into Canada to a number of categories of individuals, including 'Intra-corporate transferees', who are individuals of one member who go to work at an investment in another member. Intra-corporate transferees are granted entry for up to three years. They are defined as follows in Canada's national schedule of commitments.

> **Intra-corporate transferees**
>
> Natural persons of another member who have been employed by juridical persons of another member for a period of not less than one year and who seek temporary entry in order to render services to (i) the same juridical person which is engaged in substantive business operations in Canada or (ii) a juridical person constituted in Canada and engaged in substantive business operations in Canada which is owned by or controlled by or affiliated with the aforementioned juridical person.
>
> Intra-corporate transferees must be in one of three categories.
>
> **Executives** — Natural persons employed by a juridical person who primarily direct the management of the juridical person or establish goals and policies for the juridical person or a major component or function of the juridical person, exercise wide latitude in decision-making, and receive only general supervision or direction from higher-level executives, the board of directors, or stockholders of the juridical person.
>
> **Managers** — Natural persons employed by a juridical person who direct the juridical person, or a department or subdivision of the juridical person, supervise and control the work of other supervisory, professional or managerial employees, have the authority to hire and fire or recommend hiring, firing, or other personnel actions and exercise discretionary authority over day-to-day operations at a senior level.
>
> **Specialists** — Natural persons who possess knowledge at an advanced level of expertise and who possess proprietary knowledge of the juridical person's product, service, research equipment, techniques or management.

371 *GATS Annex on Movement of Natural Persons Supplying Services under the Agreement*.

Box 5.19 Summary of options for an IIA provision on the entry of foreign nationals and restrictions on nationality requirements for senior management

1. No provision addressing the entry of foreign nationals or nationality requirements for senior management
2. Commitment regarding the entry of foreign nationals
3. Commitment prohibiting restrictions on nationality requirements for senior management

5.11.2 Discussion of options

1. *No provision on the entry of foreign nationals or nationality requirements for senior management*

This is the most common approach in current IIAs and gives host states the maximum flexibility with respect to who is permitted to enter the country in accordance with domestic labour market, immigration and security policies. It provides no commitment for the benefit of foreign investors to allow them to bring into the host state foreign individuals to work at their investments or protection against any host state rule that requires that locals be hired to fill particular positions.

Even without an IIA commitment of this kind, however, a host state would be subject to any similar commitment that it had made under *GATS* or in any other trade or investment agreement. Such an obligation could not be subject to the dispute settlement procedures of an IIA unless the treaty contains a clause that expressly permits investors to make claims based on other state obligations that are not expressly set out in the treaty. It is also possible that an obligation regarding entry or prohibiting nationality restrictions would be incorporated into an IIA that contained an MFN clause, if the state had entered into another IIA that provided such obligations.[372]

2. *Commitment regarding the entry of foreign nationals*

For some investors, a commitment to permit the entry of foreign nationals may be valuable, though the value will depend on the extent to which bringing in foreign nationals is part of the investor's business plan and to what extent the domestic rules in the host state otherwise impose restrictions on doing so. If host state rules would have to be changed as a result of such a commitment, then access for foreign nationals

372 See Section 5.4 (Most favoured nation).

will be improved. If host state rules are already liberal, then the IIA obligation serves only to prevent the introduction of new restrictions.

Regardless of their possible value, however, only a few treaties include such a requirement. In those that do, the commitment is subject to applicable national rules and so seems not to create any real obligation. Undoubtedly, the small number of IIAs with this kind of provision reflects significant host state concerns about managing entry into the country.

3. *Commitment prohibiting restrictions on nationality requirements for senior management*

Such a provision may be an absolute commitment or, as in some treaties, be subject to national law. In the latter form, it would seem to have limited effect. Neither type of commitment is included in many IIAs. This is probably because some host states want to be able to put in place requirements that their nationals hold senior management or specialist positions with a view to facilitating the transfer of technological expertise and skills and ensuring that senior managers are responsive to local conditions. There is no guarantee, however, that these benefits will be realised in practice.

A commitment not to impose nationality restrictions may have some value to foreign investors who have an interest in ensuring that they have freedom to choose whomever they consider to be the best person for a senior management position. Host state rules that restrict this freedom may have efficiency implications for the operation of the investment. Consequently, rules restricting senior management personnel to host country nationals may deter investment. The significance of a commitment not to impose such restrictions for investors will depend on the host state's domestic policy. If the host state does not impose nationality restrictions, then the only effect of the commitment is to prevent the introduction of future measures of this kind. The value of a host state commitment not to impose restrictions on nationality will be higher if it is accompanied by a commitment to grant entry for foreign individuals to work at the foreign investor's investment in the host state.

With respect to options 2 and 3, it is possible that any more favourable obligation regarding entry or prohibiting nationality restrictions that a state has entered into in another IIA would be incorporated into an IIA, if the IIA contained an MFN clause.

5.11.3 Summary

The Guide does not include a sample provision on the entry of personnel. Only a few model treaties include such a requirement. In those that do, the commitment is subject to applicable national rules and so seems not to create an effective obligation in any case. As a result, it is not clear what benefit would attach to such a provision. At the same time, for states that are concerned about managing their domestic employment markets and protecting the integrity and security of their borders, such a provision will be unattractive despite its possible appeal to some investors. The significance of

host state policy concerns related to the entry of foreigners suggests that they will not want to risk any unexpected consequences associated with such a provision.

No sample provision restricting the ability of host states to stipulate that their nationals shall occupy senior management positions has been included in the Guide. Again, this is because such a provision is not included in the agreements of many countries. In addition, as noted above, host states may want to put in place such stipulations as a way of facilitating the transfer of expertise and skills. At the same time, restricting investors' freedom to choose whomever they consider to be the best person for a senior management position may have efficiency implications for the operation of the investment and may deter investment. Consequently, a prohibition on restricting senior management personnel to host country nationals may encourage investment to some extent by some investors. Nevertheless, the absence of such a commitment from many developed country IIA models suggests that the value of the commitment is small.

5.12 Reservations and exceptions

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As frequently noted in the Guide, concerns have been expressed that the investor protection obligations in IIAs prevent states from acting to achieve public policy objectives, even where state action is necessary to implement other international obligations.[373] Reservations and exceptions are provisions in IIAs that seek to ensure that states are not unduly constrained by IIA obligations. They are designed to ensure that state measures intended to achieve important public policy objectives are not at risk of being successfully challenged on the basis of their inconsistency with the investor protection obligations in the treaty. General exceptions often address

373 A Newcombe (2011), 'General Exceptions in International Investment Agreements', in Cordonier Segger et al., op. cit., at 365–6.

measures enacted for purposes such as the protection of public health, the environment and national security. Reservations may be used in a similar way to safeguard a state's freedom to act in a particular area but, unlike exceptions, reservations are separately listed for each party and typically are not symmetrical. They are customised to reflect the national policies and priorities of each party. Reservations can be used to permit the maintenance of specific legislation or programmes that would otherwise be contrary to the obligations in the treaty or to exclude whole sectors from the scope of the treaty or particular obligations.

The trend in IIAs is towards an expansion of the use of exceptions and reservations, though currently extensive general exceptions and reservations are included in relatively few treaties.[374] Some model treaties, such as the UK model IPPA and the Indian model BIPPA, contain few exceptions and do not contemplate reservations.[375] Others, such as the Canadian and US model treaties, create a detailed pattern of exceptions and reservations that refines the scope of the treaty's obligations in specific and complex ways.[376]

Another possible approach, analogous to an exception and discussed above, is to exclude matters from the scope of the treaty.[377] A final possibility discussed below in this section, but not found in many existing treaties, is to provide that a host state has a general right to regulate in the public interest.[378] Asserting a right to regulate is intended to ensure that a host state has a broad power to take action to achieve its public policy objectives in all areas.[379]

Each of these approaches has advantages and disadvantages as discussed below. Reservations, exceptions and scope restrictions are limited to the discrete areas of state activity to which they refer. In addition, some investor–state tribunals have interpreted exceptions and reservations narrowly on the basis that they undermine the main investment protection and promotion goals of IIAs. By contrast, a general right to regulate is intended to recognise that states have a broad general power and responsibility to regulate in the public interest that is not confined to any specific policy area. While the existence of this right is undeniable as a general proposition, it is difficult to give it specific legal content and it is not clear how it should be applied in relation to the investor protection provisions that dominate the content of

374 UNCTAD (2007), *Treaties 1996–2006*, op. cit., at 80–1.

375 UK model IPPA, Art. 7 discussed above; Indian model BIPPA, Art. 12 (excepting only measures to protect essential security interests or enacted in circumstances of a national emergency applied on a non-discriminatory basis). The IISD model treaty provides a few general exceptions but, unlike other forms of IIA, sets out a list of host state rights which appear to operate in a manner similar to exceptions (Arts. 25–8).

376 Canadian model FIPA, Arts. 9, 10, 16 and 17; US model BIT, Arts. 14, 18, 20 and 21. The COMESA Investment Agreement (2007) has a similar set of exceptions in Arts. 22–5.

377 See Section 4.5 (Scope of application).

378 The IISD model treaty adopts this approach.

379 One other possible approach discussed above is positive listing, meaning that the obligations apply to only those sectors of the host state economy that the host state lists in a schedule to the IIA. See Section 5.2 (Right of establishment) for a discussion of positive listing.

IIAs. Right to regulate provisions are not found in many IIAs and, as a consequence, such provisions have not had the benefit of extensive consideration in investor–state cases.[380]

Finally, there are a number of circumstances recognised under general customary international law that excuse a state from liability for actions that would otherwise be a breach of IIA obligations. Since these circumstances precluding liability are not based on IIA provisions, they will not be discussed in the Guide.[381]

5.12.1 IIA practice regarding exceptions

Exceptions in IIAs exempt a party state from obligations in the treaty in situations where compliance with the obligations would be inconsistent with the achievement of some public policy goal defined in the exception. In this way, exceptions are intended to ensure that the application of an IIA is balanced between protecting investors and achieving other policy goals. Exceptions may be general, in the sense that that they apply to all obligations in the treaty, or limited to specific obligations. In terms of treaty design, general exceptions and exceptions applicable to a number of specific obligations are typically set out in a separate provision while exceptions applying to single obligation are usually incorporated in the provision creating the obligation. In this section, IIA practice regarding different categories of exceptions is discussed.

Exceptions for health, the environment, public morals and law enforcement

Policy areas included in exceptions

The Canadian model treaty addresses some of the common categories of exceptions found in some existing IIAs. The Canadian model creates general exceptions which allow a party state to take measures necessary to: (i) protect human, animal or plant life or health; (ii) conserve living or non-living exhaustible natural resources; and (iii) ensure compliance with laws and regulations that are not inconsistent with the provisions of the Agreement.[382] The COMESA Investment Agreement has a similar

380 There has been some consideration of the right to regulate in the context of cases on indirect expropriation and state's police powers as well as cases considering fair and equitable treatment claims.

381 These include, for example, the defence of necessity. See, generally, A Newcombe and L Paradell (2009), *Law and Practice of Investment Treaties: Standards of Treatment*, Wolters Kluwer International, The Netherlands, at 510–28.

382 These exceptions were added to Canada's model investment treaty in 2004. The US model BIT has a broader provision dealing with environmental measures, but it does not create an exception (Art. 12.2). Bartels notes that states have used these types of clauses to increase their policy space in relation to environmental and cultural issues, as well as indigenous rights. However, these types of clauses have not addressed human rights or labour rights concerns. L Bartels (2009), 'Social Issues: Labour, Environment and Human Rights', in S Lester and B Mercurio (eds), *Bilateral and Regional Trade Agreements: Commentary, Analysis and Case Studies*, Cambridge University Press, Cambridge, at 6. With respect to exceptions to permit the enforcement of law, the ASEAN Agreement (Art. 17) and the India–Singapore CECA (Art. 6.11) go on to specify that this includes laws and regulations relating to:

set of exceptions, but lists measures to protect public morals as well,[383] a category also included in the India–Singapore CECA and the ASEAN Agreement.[384] The precise manner in which these categories are expressed is somewhat variable,[385] but these categories are common. In structure, they generally follow the well-known language of the exceptions in Article XX of the *GATT* (set out in Box 5.20).

Structure of exceptions – requirements for availability

There are several approaches to the structure of exceptions in this category. Typically, IIAs include requirements to prevent abuse of the exception by states. Often the exceptions adopt some or all of the requirements applicable to the exceptions in *GATT* Article XX. In the Canadian model, some of the exceptions follow the architecture of the exceptions in Article XX of the *GATT* closely and require that all the *GATT* requirements be met before the exception is available. The most stringent requirements under *GATT* Article XX are as follows.

- **A state measure has to be 'necessary' to achieve one of the identified goals.**[386] This requirement has been interpreted as meaning that there must not be an alternative measure reasonably available to the state to achieve the defined objective that is less restrictive of trade.[387]
- **A state measure cannot be applied in a manner that would constitute 'a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail,**[388] **or a disguised restriction on international trade'.**[389] These generally applicable requirements are sometimes referred to as the requirements of the 'chapeau' of *GATT* Article XX.[390]

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i. The prevention of deceptive and fraudulent practices to deal with the effects of a default on a contract;
ii. The protection of privacy of individuals in relation to the processing and dissemination of personal data and the protection of the confidentiality of individual records and accounts;
iii. Safety.

These follow the exceptions provided in *GATS*, Art. XIV.

383 COMESA Investment Agreement (2007), Art. 22.

384 India–Singapore CECA (2005), Art. 6.11; ASEAN Agreement (2009), Art. 17.

385 The Australia–India BIT (1999) refers to the 'prevention of diseases or pests' as well (Art. 15).

386 Such a requirement is found in Switzerland–Mauritius, Agreement between the Swiss Confederation and the Republic of Mauritius on the Promotion and Reciprocal Protection of Investment, signed 26 November 1998, in force 21 April 2000, Art. 11.5.

387 *European Communities – Measures Affecting Asbestos and Products Containing Asbestos* (Complaint by Canada) (2001), WTO Doc. WT/DS135/AB/R (Appellate Body Report).

388 Such a requirement is found in the Australia–India BIT (1999), Art. 15. See also Argentina–New Zealand, Agreement between the Government of the Argentine Republic and the Government of New Zealand for the Promotion and Reciprocal Protection of Investments, signed 27 August 1999, not yet in force, which includes a proviso that the measure be 'not applied in a manner that would constitute a means of arbitrary or unjustified discrimination' (Art. 5).

389 Such a requirement is found in Canada–Armenia, Agreement between the Government of Canada and the Government of the Republic of Armenia for the Promotion and Protection of Investments, signed 8 May 1997, in force 29 March 1999, Art. XVII.

390 These chapeau requirements appear in the India–Singapore CECA (2005) (Art. 6.11) and the ASEAN Agreement (2009) (Art. 17).

Demonstrating that a measure is necessary has proved to be a high standard in WTO cases considering *GATT* Article XX. Instead of requiring that measures are 'necessary' to achieve the policy objective, the COMESA Investment Agreement requires only that a measure be 'designed and applied' to achieve the objective, an easier standard for host states to meet.[391]

The USA adopts a different approach to measures related to the environment in its model agreement. The importance of the protection of the environment is recognised. The provision then goes on to provide as follows:

> Nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining or enforcing any measure *otherwise consistent with this Treaty* that it considers appropriate to ensure that investment activity is undertaken in a manner sensitive to environmental concerns.[392] (Emphasis added.)

A provision that requires that a measure be 'otherwise consistent' with the treaty, however, is not an exception at all. It is a guide to interpretation only.

Box 5.20 General exceptions in the *GATT*

Article XX
General Exceptions

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

a. Necessary to protect public morals;

b. Necessary to protect human, animal or plant life or health;

c. Relating to the importations or exportations of gold or silver;

d. Necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trademarks and copyrights, and the prevention of deceptive practices;

e. Relating to the products of prison labour;

f. Imposed for the protection of national treasures of artistic, historic or archaeological value;

(Continued)

391 COMESA Investment Agreement (2007), Art. 22.1. The agreement adopts a similar set of qualifications for reliance on the exceptions.

392 E.g. US–Uruguay BIT (2005), Art. 12.

(Continued)

g. Relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;

h. Undertaken in pursuance of obligations under any intergovernmental commodity agreement which conforms to criteria submitted to the CONTRACTING PARTIES and not disapproved by them or which is itself so submitted and not so disapproved;

i. Involving restrictions on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry during periods when the domestic price of such materials is held below the world price as part of a governmental stabilisation plan; *Provided* that such restrictions shall not operate to increase the exports of or the protection afforded to such domestic industry, and shall not depart from the provisions of this Agreement relating to non-discrimination;

j. Essential to the acquisition or distribution of products in general or local short supply; *Provided* that any such measures shall be consistent with the principle that all contracting parties are entitled to an equitable share of the international supply of such products, and that any such measures, which are inconsistent with the other provisions of the Agreement shall be discontinued as soon as the conditions giving rise to them have ceased to exist. The CONTRACTING PARTIES shall review the need for this sub-paragraph not later than 30 June 1960.

Article XVI of the *GATS* contains a similar list of exceptions.

Exceptions for prudential measures

Another category of exception relates to the operation of a state's financial system. For example, Canada excludes from the application of investment treaty obligations reasonable state measures 'for prudential reasons,' including:

(g) the protection of investors, depositors, financial market participants, policy-holders, policy-claimants, or persons to whom a fiduciary duty is owed by a financial institution;

(h) the maintenance of the safety, soundness, integrity or financial responsibility of financial institutions; and

(i) ensuring the integrity and stability of a Party's financial system.[393]

This kind of exception provides states with significant flexibility to act to protect people who deal with financial institutions, the financial institutions themselves and

393 Canadian model FIPA, Arts. 10.2 and 10.3.

the financial system as a whole. The only requirement is that the measures must be reasonable. The Canadian exception further provides that nothing in an IIA applies to 'non-discriminatory measures of general application taken by any public entity in pursuit of monetary or credit policies or exchange rate policies'.[394] This kind of exception can be relied on with respect to measures relating to a financial crisis, but applies to a much broader range of circumstances. In the Canadian model, restrictions on the movement of funds out of the host state are also permitted under exceptions to the funds transfer obligation discussed above, including in balance of payments emergencies.[395]

Exceptions for prudential measures are not common in existing IIAs, but increasingly appear in new treaties and generally follow the approach in the Canadian model.[396] The US model treaty has a similar provision, but it also contains a procedure to address situations in which the exception is being relied on by a state in an investor–state arbitration. Essentially, the financial authorities in each jurisdiction will be asked to make a joint determination regarding whether the exception applies and, if they make a determination, it is binding on the arbitration tribunal.[397]

The ASEAN Agreement deals with this issue by adopting the prudential measures exception in the Annex on Financial Services to the *GATS*, which is similar in coverage and effect to the Canadian model exception described above.[398]

Security exceptions

In many IIAs, parties reserve the right to take any measure to protect their 'essential security interests'. Several IIAs go on to provide that a party state can invoke a general treaty exception in situations where a requirement to comply with the agreement would impede 'the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security'.[399] This type of exception is found in the US and Canadian model agreements.[400] The US model agreement provides as follows:

> Nothing in this Treaty shall be construed:
>
> 1. to require a Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests; or
>
> 2. to preclude a Party from applying measures that it considers necessary for the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.

394 The US model BIT does not require that measures be reasonable (Art. 20).

395 See Section 5.8 (Free transfer of funds).

396 UNCTAD (2007) *Treaties 1996-2006* op. cit., at 90–1.

397 US model BIT, Art. 20.

398 ASEAN Agreement (2009), Art. 17.2. The *GATS* prudential measures exception is described in Appendix 2.

399 E.g. US model BIT, Art. 18.

400 Canadian model FIPA, Art. 10.4; US model BIT, Art. 20. The Canadian model FIPA says that 'such obligations would be those derived from the Charter of the United Nations'. Similar language is in the Japan–Korea BIT (2002) (Art. 16).

The Canadian model is more limited. Rather than simply excluding all measures for the protection of its own essential security interests, Canada's exception is restricted to measures taken in time of war, or other emergency in international relations and those that relate to arms trafficking or the implementation of national policies or international agreements related to the non-proliferation of nuclear weapons.

Typically, IIAs do not define what is meant by 'essential security interests'.[401] The US and Canadian model treaties along with some others expressly allocate to the state the power to determine when this exception applies. The exception is available whenever the state 'considers [an action] necessary for the protection of its essential security interests'.[402] This approach would seem to prevent an investor–state tribunal from finding that a measure was not related to a state's essential security interests if the state claimed that it was and relied on the exception. It may be that the only issue a tribunal could consider is whether the state was acting in good faith in invoking the exception. Some other IIAs except only actions that are 'necessary' to protect essential security interests. In the Australia–India BIT, measures qualify for the exception only if they are applied 'reasonably and on a non-discriminatory basis'. With these kinds of words, arbitral tribunals would be able to assess whether the criteria for the availability of the exception are met.

Another limiting approach is to restrict the security exception to certain obligations, such as national treatment or MFN treatment.[403] It is also possible to impose procedural requirements as a condition of eligibility for the exception, such as prior notice of a measure relying on the exception and its purpose.[404]

A few IIAs deal with an exception for national security issues in the context of dispute settlement only. Instead of having an explicit exception for measures related to security in the treaty, these IIAs provide that investors cannot invoke the dispute settlement procedures of the agreement if a state justifies its action as based on national security considerations.[405]

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401 Some treaties use different words. For example, Hong Kong–New Zealand, Agreement between the Government of Hong Kong and the Government of New Zealand for the Promotion and Protection of Investments, signed 6 July 1995, in force 5 August 1995, refers to 'essential interests' (Art. 8), while Caribbean Community–Cuba, Trade and Economic Cooperation Agreement between the Caribbean Community and the Government of the Republic of Cuba, signed 5 July 2000, not yet in force, refers to 'national security interests' (Art. XVII).

402 Canadian model FIPA, Art. 10.4. Similar language is in the Japan-Korea BIT (2002) (Art. 16). The COMESA Investment Agreement (2007) requires that the measure be 'designed and applied' to protect national security.

403 *Ad* Art. 3(a) of the Germany–Mexico BIT provides an exception that only applies to national treatment and MFN: 'The measures taken by reason of national security, public interest, public health or morality shall not be considered as a "less favourable treatment", according to Article 3'.

404 E.g., Japan–Vietnam, Agreement between Japan and the Socialist Republic of Vietnam for the Liberalization, Promotion and Protection of Investment, signed 14 November 2003, in force 19 December 2004, Art. 15.

405 Sweden–Mexico, Agreement between the Government of the Kingdom of Sweden and the Government of the United Mexican States concerning the Promotion and Reciprocal Protection of Investments, signed 3 October 2000, in force 1 July 2001, Art. 18. In an exchange of letters pursuant to Art. 6.12(4) of the India–Singapore CECA (2005), Singapore and India agreed that a state decision that it could rely on the national security exception in the agreement could not be reviewed by any tribunal.

Some security exceptions, such as Canada's, do not include measures to protect 'public order', though this is provided for in some other treaty models.[406] Protecting public order seems to contemplate measures needed to maintain peace and the rule of law in a state, rather than to deal with more serious threats of war or armed conflict which may threaten a state's essential security interests. Typically, because of its potentially broad application, an exception for measures to maintain the public order is subject to certain conditions that are based on the chapeau of *GATT* Article XX. An IIA might contain a proviso that such measures will not be applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination in the party state, or a disguised restriction on investment. Also, measures may have to be necessary to be eligible for the exception.[407]

Exceptions for taxation

Domestic tax regimes often have discriminatory elements that favour domestic businesses. For this reason, some countries exclude taxation measures entirely from the scope of their IIAs.[408] The Canadian and US model treaties have a more nuanced approach that permits expropriation claims based on taxation measures, provided there is no agreement among the tax authorities of the party states that the expropriation claim should *not* proceed.[409] If the tax authorities agree that there is no expropriation then the claim cannot proceed. Claims related to tax measures cannot be made on the basis of other provisions of the treaty. The approach in the Canadian and US models provides limited protection for investors where the tax measure is so severe that at least one party state, probably the investor's state, thinks it is an expropriation. The approach in the Norwegian draft model APPI is similar, except that it contemplates that the competent tax authority of any treaty party can decide that a measure should be considered under the expropriation provision.[410] The COMESA Investment Agreement adopts a similar approach.[411]

Exceptions for culture

A number of states, including France, Canada and China, have included exceptions in their IIAs intended to protect their ability to enact measures to protect local culture. In its treaties, France has included a broad exception for measures 'in the

406 E.g. Norwegian draft model IPPA, Art. 24(i); Korea–Japan BIT (2002), Art. 16(1)(d); Finland–Kyrgyzstan, Agreement between the Government of Finland and the Government of the Kyrgyz Republic on the Promotion and Protection of Investments, signed 3 April 2003, in force 8 December 2004, Art. 14.2.

407 E.g. Korea–Japan BIT (2002), Art. 16(1)(d); Finland–Kyrgyzstan BIT (2003), Art. 14.2.

408 UK model IPPA (Art. 7) excludes all international and domestic measures related to taxation from the national treatment and MFN obligations. See, similarly, Argentina–New Zealand BIT (1999), Art. 5; Mexico–Germany BIT (1998), *Ad* Art. 3(b).

409 Canadian model FIPA, Art. 16; US model BIT, Art. 21. The Canadian model has a similar mechanism to permit claims that there has been a breach of an agreement between an investor and the host state by a tax measure unless the tax authorities determine that there is no breach of the agreement.

410 Norwegian draft model IPPA, Art. 28.

411 COMESA Investment Agreement (2007), Art. 23.

framework of policies designed to preserve and promote cultural and linguistic diversity'.[412] This exception would appear to be broad enough to protect measures directed at the production of culture, such as rules limiting the screening of foreign films, as well as any policies in other areas within 'the framework of policies' related to culture, which might include the manufacture and distribution of cultural products, however defined.[413] A few other states have included provisions that broadly exempt all measures that the state determines are designed to protect culture.[414]

Canada's model treaty contains an exception that applies to measures related to cultural industries.[415] This is a broad exclusion of entire sectors of activity related to cultural products, though it does have the benefit of being more specific and predictable than the French exception. Canada's definition of cultural industries is set out in Box 5.21.

Box 5.21 Definition of cultural industries in the Canadian model FIPA

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;

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.

The ASEAN Agreement and the India–Singapore CECA adopt a narrower approach. These treaties simply include the language found in *GATT* Article XX – 'measures imposed for the protection of national treasures of artistic, historic or archaeological value' – and incorporate the requirements of the chapeau of Article XX.[416]

412 E.g. France–Uganda, Agreement between the Government of the Republic of France and the Government of the Republic of Uganda on the Reciprocal Promotion and Protection of Investments, signed 3 January 2003, in force 20 December 2004, Art. 1.

413 Ibid.

414 E.g. Norwegian draft model IPPA, Art. 27.

415 Canadian model FIPA, Art. 14.6.

416 *GATS*, has a similar chapeau limiting the availability of most exceptions in that agreement (GATS, Art. XIV).

Exceptions for non-disclosure of confidential information

As noted above, many countries have exceptions that allow them not to disclose confidential personal information.[417] Often the exception for confidential information is included in IIA transparency provisions. Canada's model includes a general exception to ensure that the agreement creates no requirement for disclosure of information that would impede law enforcement or run contrary to a state's domestic rules protecting government confidentiality and personal privacy. The extension of the exception to government confidentiality was included to address Canada's concern that it should not have to disclose confidential government information that it was ordered to disclose by investment arbitration tribunals in investor–state cases under NAFTA.[418]

Exceptions for government procurement and subsidies

One of the common ways in which many governments support local businesses is to give them preferences when the government buys goods and services, known as government procurement. Discriminatory procurement practices may affect the business of foreign investors who supply goods or services in competition with local suppliers. The Canadian and US model agreements create exceptions for procurement by governments and state enterprises that allow them to prefer local businesses.[419] These exceptions apply only to the national treatment and MFN obligations in the Canadian and US model agreements, as well as to the commitments regarding the entry of foreign personnel and prohibiting nationality requirements in these models. As discussed below, these are the obligations most likely to be breached by procurement practices.

Subsidies are another way in which many governments support national businesses. Both the Canadian and US models create exceptions for government subsidies, including government-supported loans, guarantees and insurance.[420] These exceptions are also limited to the national treatment and MFN obligations and the obligations regarding the entry of personnel and nationality requirements in the Canadian and US model agreements. The India–Singapore CECA exempts subsidies and grants from all obligations in its provision defining the scope of the agreement.[421] Few other agreements address subsidies.

Other exceptions

Ultimately, each state must decide for itself what policy areas need the benefit of exceptions. While the categories of exceptions discussed above are those that are currently found in some IIAs, it may be that for a particular state additional exceptions

417 See Section 5.10 (Transparency).

418 *United Parcel Service of America, Inc. v. Canada*, UNCITRAL, Decision of the Tribunal Relating to Canada's Claim of Cabinet Privilege, 8 October 2004, at para. 11; *Pope & Talbot v. Canada*, UNCITRAL, Decision by Tribunal on Privilege , 6 September 2000, at para. 1.4.

419 Canadian model FIPA, Art. 9.5(a); US model BIT, Art. 14.5(a).

420 Canadian model FIPA, Art. 9.5(b); US model BIT, Art. 14.5(b).

421 The India–Singapore CECA (2005), Art. 6.2(5).

are desirable. For example, an exception for development programmes was discussed above.[422] Equally, some of the categories listed above may not be necessary.

One further category of exception should be considered if an IIA contemplates investor obligations, such as obligations related to human rights, labour rights, indigenous peoples' rights and anti-corruption, or host state obligations in these areas, including obligations related to the enforcement of investor obligations. All of these kinds of obligations are discussed below in the Guide. Where such obligations are present in an IIA, it would be useful for the agreement to provide expressly that actions taken by a party state to give effect to obligations it undertakes or to enforce investor obligations are not breaches of the investor protection obligations in the agreement.

Scope of exceptions

In principle, exceptions may apply to all obligations in an IIA or only to specified obligations. The Canadian model provides examples of both. The general exceptions relating to health and the environment, prudential measures, cultural industries and security interests apply to all obligations. The exceptions for subsidies and procurement, however, apply only to national treatment, MFN and a few other obligations. In general, exceptions that apply to all obligations provide more flexibility to host states, while narrower exceptions provide greater certainty and predictability for investors. It is impossible to anticipate all policy measures that a state may want to adopt in a particular area, but some kinds of government measures are more likely to conflict with particular obligations. For example, as noted above, since government procurement policies are most likely to discriminate in favour of local suppliers, an exception from the national treatment obligation is most likely to be needed to protect government procurement measures. There may be little need to except government procurement from other obligations. For example, since procurement decisions are unlikely to constitute expropriation, an exception from an IIA obligation not to expropriate without compensation would not be needed. In each case, a state needs to consider what its actual policies are and identify the areas of domestic policy in which it wants to retain flexibility for the future. On this basis, a state can determine what exceptions it needs in an IIA. These exceptions will then have to be negotiated with the other party. As will be discussed below, for specific policies and policy areas that only one state wants to protect, reservations may be used instead of exceptions.

An additional issue arises in connection with the obligation not to expropriate without paying compensation and fair and equitable treatment. As discussed, these two IIA obligations reflect customary international law requirements, at least to some extent. While states may contract out of their customary law obligations through exceptions, it would undoubtedly seem anomalous to most capital-exporting countries that an IIA contained exception provisions that would give their investors less substantive protection than they would have had without the treaty. If an action of a host state that would be an expropriation or a breach of fair and equitable treatment fits within an exception, then there is no international liability for the

422 See Section 5.3 (National treatment).

state. For example, if the state were to expropriate land owned by a foreign investor to create a nature reserve for endangered species, such an action might fit within an exception for the protection of exhaustible natural resources in the IIA, so long as the expropriation did not discriminate between foreign and domestic landowners and met any other requirements for the availability of the exception. In this case, the state would have no obligation under the treaty to compensate any foreign investor who had been expropriated. By virtue of the exception, there would be no breach of the treaty. Such a result would be inconsistent with the customary international law obligation of states to provide compensation for expropriation and domestic legal requirements in most states.[423] The application of many exception provisions in IIAs to the expropriation and fair and equitable treatment obligations has never been tested. It may be that some other interpretation consistent with customary law would be adopted. Nevertheless, some states may object to treaty provisions that create exceptions to these basic customary international law obligations.

Safeguards and phase-ins

In addition to fairly broad exceptions, the COMESA Investment Agreement has a form of safeguard provision under which a member state that suffers or is threatened with any serious injury as a result of its commitments under the agreement may take such emergency measures 'as may be necessary to prevent or to remedy such injury'. A member state's use of such emergency measures is subject to review by the COMESA Common Investment Area Committee, composed of ministers of the member states.[424] Few other treaties contain such safeguard provisions in relation to investment.[425]

An alternative approach to facilitate a gradual adjustment to IIA commitments would be to have obligations phased in over time. This could be achieved through an IIA commitment to accept a particular obligation at some fixed date in the future or to progressively remove restrictions that a host state had excluded from its obligations through reservations.

Issues related to the use of exceptions

As noted in the previous section, there has been relatively little arbitral case law on the use of exceptions in investment agreements. Commentators have expressed a number of concerns about the effectiveness of exceptions.

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423 This point was suggested to the authors by the work of Professor Andrew Newcombe.

424 COMESA Investment Agreement (2007), Art. 24.

425 The agreement between the member countries of the Caribbean Community contains a general emergency safeguard mechanism. In that agreement, a member state may impose restrictions on services trade which could include investment where the exercise of rights granted in the treaty creates 'serious difficulties in any sector of the economy of a member State or occasions economic hardships in a region of the Community' where that state has been adversely affected. See Caribbean Community, *Revised Treaty of Chaguaramas Establishing the Caribbean Community Including the CARICOM Single Market and Economy*, signed 5 July 2001, in force 5 February 2002, and subsequently revised, Art. 47. A sector-specific safeguard in financial services was created in NAFTA (1992), allowing Mexico to impose caps on market share if certain foreign ownership levels were surpassed after it removed existing restrictions at those levels. See NAFTA (1992), Annex VII, Schedule of Mexico, Part B.

- **Exceptions will be interpreted narrowly because they are inconsistent with the overall purpose of IIAs, which is to protect and promote investment.** This approach has been taken in a number of investor–state arbitration cases.[426] Though this approach has been criticised[427] and not universally applied,[428] it appears to be the dominant approach. In part, this approach could be avoided by changing the way in which the objectives of the agreement are described. How this might be done is discussed above.[429]

- **A state has the burden of proving that its measure falls within an exception.** A number of investor–state tribunals have adopted this approach.[430] In general, party states in investor–state arbitrations cases have to prove that they are entitled to rely on provisions of an IIA that they invoke.

- **Exceptions necessarily refer to a discrete list of policy areas in which state action is permitted despite being otherwise inconsistent with the IIA's investor protection obligations. Therefore they can never provide comprehensive protection for all future state regulation and may even provide less flexibility than is built into the substantive standards of investor protection.** In a number of cases, investor–state arbitration tribunals have interpreted investor protection obligations flexibly to permit non-discriminatory host state regulation without relying on exceptions. For example, as discussed above, cases interpreting when investments are 'in like circumstances' for the purposes of the national treatment obligation have permitted states to treat foreign investors less favourably than domestic investors if doing so is to achieve some legitimate non-discriminatory public policy goal. For the purposes of the measure, the foreign investor and the domestic investor were found not to be in like circumstances.[431] Unlike exceptions, the category of acceptable government policy is not closed under the national treatment obligation. Some commentators have suggested that there is far more flexibility under national treatment than would exist through exceptions, especially if exceptions are limited by the kinds of qualifications that are present in the chapeau of *GATT* Article XX.[432]

  Another example of flexibility built into a substantive investor protection obligation is the expropriation obligation. Many agreements now include a specification of what constitutes state regulation as opposed to expropriation that is not tied to any particular policy area.[433]

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426 Newcombe, 'General Exceptions', op. cit., at 361–3.

427 Ibid. at 363–4.

428 *United Parcel Service of America, Inc. v. Canada*, op. cit. (dealing with the cultural exemption in NAFTA).

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

430 Ibid., at 154.

431 See Section 5.3 (National treatment). The tribunal in *SD Myers*, op. cit., said that the national treatment enquiry was akin to the kind of analysis required in applying *GATT* Art. XX exceptions (at para. 29).

432 N DiMascio and J Pauwelyn (2008), 'Non-Discrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?', 102 *American Journal of International Law* 48, at 82–3; Newcombe, 'General Exceptions', op. cit., at 367–9.

433 See Section 5.6 (Limitations on expropriation and nationalisation).

- **Exceptions may be considered by investor–state arbitration tribunals to represent an exhaustive list of the policy areas in which the party states want flexibility to regulate. In some cases this will result in narrower protection than if the exceptions were not in the IIA.** Because the parties to an IIA expressly described the policy areas that are to be excluded from the application of the investor protection provisions in detailed exception provisions, an investor–state tribunal might conclude that states did not intend to protect their flexibility in any other area. This might encourage tribunals to abandon the approach to the application of investor-protection provisions described in the previous point and to interpret investor protection provisions in IIAs less flexibly than they have in the past.

These kinds of concerns discouraged the IISD from including general exceptions in its model agreement. Instead, a right to regulate was provided.

5.12.2 IIA practice regarding the right to regulate

Some IIA models seek to address concerns regarding whether states are free to regulate to achieve their development goals by including a provision setting out a positive right to regulate. For example, Article 25 of the IISD model treaty states:

> A. Host states have, in accordance with the general principles of international law, the right to pursue their own development objectives and priorities.
>
> B. In accordance with customary international law and other general principles of law, host states have the right to take regulatory or other measures to ensure that development in their territory is consistent with the goals and principles of sustainable development, and with other social and economic policy objectives…[434]

In addition, in order to address the uncertainties created by investor–state arbitration decisions with respect to the balancing of the host state's right to regulate and the rights of investors under IIAs,[435] the IISD model expressly provides that the right to regulate is to be considered 'within a balance of the rights and obligations' of investors and investments and host states.[436] The IISD model also seeks to ensure that non-discriminatory regulation introduced by the host state to comply with its international obligations is not a breach of the IIA.[437]

The inclusion of a positive right to regulate in an IIA is an attractive way to protect state regulatory flexibility. Because it is not tied to any particular policy

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434 See also the European Free Trade Association–Ukraine Free Trade Agreement, signed 24 June 2010, in force 1 June 2012, and Art.12 of the Norwegian draft treaty, for more qualified statements of the right to regulate.

435 H Mann (2008), *International Investment Agreements, Business and Human Rights: Key Issues and Opportunities*, IISD Publication Centre, Winnipeg, at 20.

436 IISD model treaty, Art. 25.

437 IISD model treaty, Art. 25. The IISD model treaty provides for the implementation of the provisions of the IIA into domestic law for the purpose of allowing for its enforcement in host state courts. This would ensure that the right to regulate is recognized in this context as well.

area, it provides comprehensive cover for state regulatory actions in all areas, unlike exceptions that are limited to specific policy areas. In addition, asserting a right to regulate should avoid the problem of narrow interpretation that has limited the effective scope for relying on exceptions in investor–state cases. The right to regulate is given equal status with investor protection. Even though a general right to regulate has not been incorporated in IIAs, it is consistent with the police powers doctrine developed in expropriation cases under customary international law to define permitted state regulation that should not be considered an expropriation.

Nevertheless, a right to regulate raises several issues.

- **Because a general right to regulate is a novel type of provision not present in existing IIAs, it is not clear how such a right would be interpreted in investor–state arbitration.** One presumed benefit of preserving a state's regulatory flexibility through a right to regulate provision is that it lessens the burden on the state to demonstrate that a measure challenged by an investor is permitted. However, it is not obvious that this benefit would be realised in practice. To rely on an exception, the state has the burden of showing that its measure is within the exception. With a right to regulate, the investor would have the burden of demonstrating a breach of a substantive obligation, including, if raised by the state, demonstrating that the measure was not a legitimate exercise of the right to regulate, since the right qualifies and limits the state's obligation to the investor. Inevitably, however, the state would have to produce arguments that the measure was within its right to regulate to counter the arguments put forward by the investor, so the effect of creating a right as opposed to an exception or reservation may not be so different in practice in investor–state arbitration.
- **The scope of the right to regulate is unclear**. While states are entitled to regulate, it is difficult to know what kind of state activity falls within this right. In addition, it is not clear how a right to regulate should be applied in relation to the investor protection provisions in IIAs. If a state successfully argues that its action is within its right to regulate, does that mean that the investor protection provisions simply do not apply, or is a more nuanced balancing of investor protection and the state's right to regulate required in each case? For example, is it necessary for the regulatory action by the state to be proportional to the harm it addresses for it to be upheld when it violates one of the substantive investor protection provisions? Because of this uncertainty, reliance on a right to regulate approach would seem to leave significant discretion to investor–state tribunals to determine what it permits on particular facts and impair the predictability of IIA obligations.
- **Exceptions may be easier to negotiate than a right to regulate.** A final, more practical, reason to prefer seeking to preserve host state flexibility in an IIA through exceptions and reservations, rather than a right to regulate, is simply that exceptions – indeed increasingly broad exceptions – and specific reservations are more and more the norm in current IIA practice. This may make it easier to negotiate specific exceptions than an open-ended right to regulate.

5.12.3 IIA practice regarding reservations

A number of treaties contemplate that each party state will list reservations that exclude specific sectors or measures from the application of some or all of the obligations in the IIA.[438] This is a form of negative listing.[439] Reservations in an IIA allow parties to customise their obligations by carving out specific measures (sometimes referred to as 'non-conforming measures'), policy areas or sectors where they want to preserve their freedom to regulate without regard to the requirements of the agreement. For example, the Canadian and US model treaties contemplate that reservations may be taken for sectors and specific non-conforming measures listed in annexes to the agreement for each party state.[440] Reservations can be listed, however, only in relation to the obligations regarding national treatment, MFN, the prohibition on performance requirements and the prohibitions on nationality requirements for senior management and entry restrictions in those models.[441] Significantly, treaty requirements related to fair and equitable treatment, expropriation and the free transfer of funds are obligations against which reservations may not be taken under either the US or Canadian model. The reservations include the following:

- All existing non-conforming measure maintained by a:
    - Party state at the national level and listed in its schedule,
    - Sub-national government;
- The continuation or renewal of any such non-conforming measure and any amendment to any such non-conforming measure that *does not increase its non-conformity* with the IIA obligations regarding national treatment, MFN, the prohibition on performance requirements and the prohibition on nationality requirements for senior management and entry restrictions; and
- Any measure that a party state currently maintains *or adopts in the future* with respect to sectors, sub-sectors or activities set out in its schedule.

All these categories of measures are exempt from the listed obligations.[442]

This approach in the Canadian and US agreements combines specific listing of existing national measures with the exclusion of whole sectors and areas of policy-making. For example, the US typically 'reserves the right to adopt or maintain any measure according rights or preferences to socially or economically disadvantaged

438 Reservations in this context are not unilateral statements by a state at the time it signs or ratifies a treaty in which it purports to exclude or modify the effect of the treaty, but rather a provision in the treaty agreed to by all parties that limits the application of the treaty in some way for one party.

439 See Section 5.2 (Right of establishment).

440 Canadian model FIPA, Art. 9; US model BIT, Art. 14. See, similarly, China–Germany, Agreement between the People's Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments, signed 1 December 2003, in force 11 November 2005.

441 The Canadian model FIPA also includes the prohibition on restrictions on entry in its list of obligations to which reservations apply.

442 A similar approach is taken in the ASEAN Agreement (2009), Art. 9.1.

minorities'.[443] Also, all existing measures by sub-national governments are excluded under the Canadian and US models. This means that it is not necessary to conduct a survey of sub-national measures to prepare a list of measures that are excluded from the identified obligations. From an investors' point of view, this approach is less transparent than the specific listing required for national level measures because it does not disclose the restrictions that are in place.

One important feature of the Canadian and US approaches is what has been referred to as a 'ratchet effect' associated with the reservations for specific measures. The exclusion for a listed non-conforming measure applies only to the measure in the form that it takes when the agreement comes into force and to any amendments that do not make the measure less consistent with the obligations in the agreement. As a result, if a party state changes a listed measure to, for example, remove a preference in favour of domestic businesses, then the reservation continues to apply to the amended measure. However, the party state cannot subsequently reinstate the preference or change the measure in any other way that makes it less consistent with its obligations under the IIA. In effect, once a party liberalises its regime, the new level of openness provided by the party immediately become part of the party's bound obligations in the sense that the obligations of the agreement apply to any subsequent change, other than one that further liberalises the party's regime. In this sense, liberalisation by a party ratchets up the level of the party's obligation.

An alternative approach would be to provide that a host state commits not to change its regime to make it less liberal than provided for in its list of reservations. This is the approach adopted in the *GATS*. Member states commit to accord services and services suppliers from other members treatment no less favourable than under the terms and conditions set out in their national schedule of commitments.[444] Under the agreement a state could liberalise its regime by, for example, removing a preference in favour of domestic businesses and subsequently reinstate the preference.

The COMESA Investment Agreement, the India-Singapore CECA and the ASEAN Agreement all contemplate reservations.[445] Only the COMESA Investment Agreement, however, provides for reservations from all treaty obligations. Nevertheless, even if some IIA obligations are not subject to reservations, the impact of an IIA for a country on its policy-making flexibility will be highly dependent on the depth and breadth of reservations included for its benefit.

An alternative to reservations that can have the same functional effect, but is administratively simpler to implement, is to limit the obligations undertaken in a treaty to specific sectors listed in an annex to the IIA. This approach, called positive listing, was discussed above.[446] It is typically less onerous for host states because it does not require an exhaustive inventory of non-conforming measures to be undertaken

443 E.g. NAFTA (1992) Annex II, Schedule of the United States.

444 *GATS*, Arts. XVI.1, XVII.1.

445 India–Singapore CECA (2005), Art. 6.16; ASEAN Agreement (2009), Art. 9; and COMESA Investment Agreement (2007), Art. 18.

446 See Section 5.2 (Right of establishment).

to ensure that they are excluded from an IIA by listing them. Such an inventory is required if a negative list approach is followed. As a practical matter, the burden associated with negative listing is significantly mitigated in relation to a particular negotiation where the state has undertaken an identical exercise in relation to a previous negotiation. A disadvantage of positive listing for investors is that the remaining restrictions in sectors that a state has not listed are not disclosed to them.

Box 5.22 Summary of options for exceptions, reservations and the right to regulate

1. *No exceptions or reservations*
2. *General right to regulate but no (or few) exceptions or reservations*
3. *Including exceptions for measures to achieve an identified policy objective*

   Exceptions may only be available if requirements like those in *GATT* Article XX have been satisfied. Under Article XX, for some exceptions to be available for a measure, the measure:

   i. Must be necessary to achieve the identified policy objective;

   ii. Must not be applied in a discriminatory manner;

   iii. Must not be applied in an arbitrary or unjustifiable manner, or so as to constitute a disguised restriction on international trade.

4. *Including reservations for specific measures or all measures in an identified policy area*

5.12.4 Discussion of options

1. *No exceptions or reservations*

Many IIAs contain few exceptions or none at all and do not contemplate reservations. This is especially true in relation to BITS. FTAs often have exceptions that apply to investment commitments. Some argue that, even in the absence of exceptions and reservations, the substantive investor protection obligations are inherently flexible enough to accommodate legitimate host state regulation. Unfortunately, investor–state arbitration tribunals have not consistently interpreted IIA obligations to provide such flexibility. To some extent, this can be addressed by adopting some of the provisions discussed elsewhere in the Guide that limit the scope of the investor protection provisions. As noted below, exceptions and reservations can provide more specific protection for government policy-making in specific areas, but are also subject to some limitations.

2. *General right to regulate but no (or few) exceptions or reservations*

A general right to regulate expressed in an IIA provides comprehensive cover for state regulatory actions in all policy areas because, unlike exceptions, it is not tied

to any particular area. In addition, providing a right to regulate should avoid the problem of narrow interpretation of exceptions that has limited the effective scope for states to rely on exceptions in some investor–state cases. On the other hand, a right to regulate is a new and novel feature not common in existing IIAs. It is not clear how such a right would be interpreted in an investor–state arbitration case. Its presumed benefits over exceptions may not materialise in practice. In particular, it is not certain how a right to regulate would operate to protect a host state's action that would otherwise be a breach of a substantive investor protection obligation or what would be the burden on the host state to justify its action as falling within its right to regulate.

3. *Including exceptions for measures to achieve an identified policy objective*

Exceptions provide a clear expression of party states' intention to exclude certain areas of policy-making from the scope of IIA obligations. They are increasingly being used in IIAs for this purpose, though exceptions remain rare in BITS. Depending on the scope, number and content of exceptions, they may deter some investors by carving out areas of policy-making from the investor protection provisions in the agreement. Reliance on exceptions may be subject to some limits in practice.

- Exceptions may be interpreted narrowly where they are determined to be inconsistent with the overall purpose of an IIA that is intended to protect and promote investment. In part, this could be addressed by changing the way in which the objectives of the agreement are specified. How this might be done is discussed above.[447]
- A state has the burden of proving that its measure falls within an exception. A number of investor–state tribunals have adopted this approach.
- Exceptions necessarily refer to a discrete list of policy areas in which state action is permitted, even if it would otherwise be inconsistent with the IIA investor protection obligations. Therefore they can never provide comprehensive protection for all future state regulation and may provide less flexibility than is built into the substantive standards of investor protection.
- Exceptions may be considered by investor–state arbitration tribunals to represent an exhaustive list of the policy areas in which the party states want flexibility to regulate; in some cases this may result an interpretation of the substantive investor protection obligations in a manner that provides less flexibility for host states than if the exceptions were not in the IIA.

In addition to these possible limitations, the effectiveness of exceptions will depend on their form. To the extent that they are only available if the requirements of *GATT* Article XX have been satisfied, their availability in practice will be limited. At the same time, these limits on availability provide certainty and predictability

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

for investors. Under Article XX, for exception to be available for a measure, in most cases, the measure:

i. Must be necessary to achieve the identified policy objective;

ii. Must not be applied in a discriminatory manner; and

iii. Must not be applied in an arbitrary or unjustifiable manner, or so as to constitute a disguised restriction on international trade.

In IIAs providing exceptions, the general exceptions for measures to protect health or the environment tend to be made subject to these requirements, whereas exceptions for measures related to prudential considerations, essential security interests, taxation, culture, non-disclosure of confidential information, subsidies and government procurement tend not to be. Indeed, in the case of some of these exceptions, including, in particular, the security exceptions, the host state often has the power to self-determine if the exception is available. This provides maximum flexibility for host states, but creates a lack of predictability that may be of concern to capital-exporting states and their investors. In the COMESA Agreement, the language 'designed and applied' to achieve a particular objective is used to define when an exception is available, instead of the requirement that a measure be necessary to achieve the objective in order to provide greater flexibility for host states. Another alternative would be to require only that the state action be proportional to the importance of the objective the state is seeking to achieve.

4. *Including reservations for specific measures or all measures in an identified policy area*

Reservations safeguard a state's freedom to act in a particular area to ensure the attainment of important public policy objectives but, unlike exceptions, they are separately listed for each party and typically are not symmetrical. They permit IIA obligations to be cut back to reflect national policies and priorities. Reservations can be used to permit the maintenance of specific legislation or programmes that would otherwise be contrary to the obligations in the treaty, or they can carve out entire sectors or policy areas. They may be general or, as is more common, limited to specific categories of treaty obligations.

The use of reservations is becoming more common in IIAs but can raise the same issues as discussed above with respect to exceptions. Their greater specificity and typically unqualified expression, however, increase the likelihood that states will be able to rely on them successfully, leading to increased predictability. Depending on the scope, number and content of reservations, they may deter some investors by carving out areas of policy-making from the investor protections in the agreement.

With respect to options 2, 3 and 4, it is possible that any more favourable IIA obligations that a state has entered into in another IIA would be incorporated into an IIA that contained an MFN clause. On this basis, an investor may argue that an exception or reservation in the IIA that does not appear in another IIA should not apply.[448]

448 See Section 5.4 (Most favoured nation).

5.12.5 Discussion of sample provisions

The introduction of much broader exceptions and reservations in the Canadian model treaty and some other IIAs suggests that there is an opportunity to adopt an approach to reservations and exceptions that is more nuanced, balanced and flexible than is common in most existing IIAs. In particular, exceptions and reservations may be used to preserve policy space in areas that are important for sustainable development. The sample provision incorporates an extensive pattern of reservations and exceptions, such as is found in the Canadian model agreement, the COMESA Investment Agreement and other IIAs, but adds several additional provisions designed to ensure that host states have adequate flexibility to make policy to achieve sustainable development.

Policy objectives of general exceptions: The policy objectives drawn from *GATT* Article XX and recited in the Canadian model have been included, but the list of objectives has been expanded to reflect IIA practice and sustainable development considerations. The policy areas in the sample provision are:

- Human, animal or plant life or health;
- Internationally and domestically recognised human rights, labour rights and the rights of indigenous peoples;
- The environment, including, but not limited to, the conservation of living or non-living exhaustible natural resources;
- Public order;
- Prudential measures;
- Essential security interests;
- Culture;
- Taxation;
- Subsidies;
- Government procurement;
- Disclosure of confidential information.

In addition, measures to ensure compliance with laws and regulations that are not inconsistent with the provisions of the IIA and measures to comply with international obligations are excluded.

Ultimately, each state must decide for itself what policy areas need the benefit of exceptions. The suggested list of areas may need to be adjusted. For example, if an IIA imposes investor obligations related to human rights, labour rights, indigenous peoples' rights and anti-corruption, or host state obligations in these areas, it would be useful to expressly provide that actions taken by the host state in order to give effect

to these obligations or enforce them could not be considered breaches of the other obligations in the agreement.[449]

Requirements for availability of exceptions: The sample provisions adopt an approach to the availability of exceptions that builds on existing practices to create more space for states to regulate. Nevertheless, in some of the exception provisions, requirements for availability have been included in the interests of providing certainty to investors. The chapeau approach from *GATT* Article XX has been maintained with respect to measures taken to achieve the first three policy objectives listed above and measures to ensure compliance with laws and regulations that are not inconsistent with the provisions of the IIA, as has been done in the Canadian model and some other agreements. Such measures will be valid only if they do not constitute arbitrary or unjustifiable discrimination between investments or between investors and are not a disguised restriction on investment. These are common limitations that are intended to ensure that the exceptions will be relied on only where there is a genuine connection between the measure and the policy objective identified in the exception. The requirement that the measures be 'necessary' to achieve the listed objectives in the Canadian model has been replaced with a requirement that they be 'designed and applied' to achieve the indicated objectives, following the COMESA Investment Agreement. The requirement that a measure be 'necessary' to the achievement of the objectives was not used on the basis that it was unduly restrictive. To require the host state to demonstrate that a measure is 'necessary' to achieve its stated policy objective places an onerous burden on that state in light of WTO jurisprudence interpreting *GATT* Article XX, which might be applied to the interpretation of similarly worded IIA exceptions.

An exception for measures to maintain public order has been included. To allay fears that such an exception creates a very open-ended authorisation for government action, the exception extends only to actions 'necessary' for the maintenance of public order, as is found in a number of agreements.

The exception for essential security interests is expressly made self-determining. None of the other exceptions have language that limits their availability, except that measures to comply with international obligations under other treaties must be non-discriminatory.

With respect to the cultural exception, the more specific and predictable Canadian approach to the exception has been adopted. An exception is created for measures

449 Investor obligations related to human rights, labour rights, indigenous peoples' rights and anti-corruption are discussed below in Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence), Section 6.9 (Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights), Section 6.10 (Investor obligation to comply with core labour standards), Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption). State obligations relating to human rights, labour rights, indigenous peoples' rights, environmental protection and anti-corruption are discussed in Section 6.12 (Other rights and obligations of party states). State enforcement of investor obligations is discussed in Section 6.13 (Enforcement of investor obligations) and Sections 6.14–6.17.

related to cultural industries, which is defined in the sample provision on definitions.[450] This is broader than the exception for the protection of national treasures in *GATT* Article XX that is incorporated in some IIAs. Each country should consider whether the list of cultural industries in the definition of that term is sufficiently broad to include the domestic cultural activities that it wants to protect from the obligations of the IIA.

Taxation measures excluded except from expropriation obligation in some circumstances: Rather than excluding tax measures in their entirety as in the UK model agreement, the sample provision follows the approach in the US and Canadian models. Tax measures are excluded from all but the expropriation obligation, and expropriation claims can proceed in relation to taxation measures only if the competent authorities in both parties cannot agree that the measure was not an expropriation.[451] This gives the parties some control over such claims.

Government procurement and subsidies are excluded from the national treatment and MFN obligations: Limiting the exclusion in these two areas to the national treatment and MFN obligations follows the Canadian and US models and has been adopted on the basis that these are the obligations most likely to constrain domestic policy in these areas. These are areas in which states often discriminate.

In the sample provision, national treatment does not apply where a party state grants a financial institution an exclusive right to deliver activities or services forming part of a public retirement plan or statutory system of social security. States may prefer that such an institution carrying out such an important public function be domestically controlled.

Application to expropriation and FET: In light of the existence of a customary international law obligation regarding compensation for expropriation, none of the exceptions apply to the expropriation provision other than the exception for taxation measures described above. In accordance with the expropriation provision itself, however, measures designed to achieve legitimate public policy objectives cannot be indirect expropriations.[452] The exceptions do, however, apply to the fair and equitable treatment obligation. This was done because of the inherently broad and unpredictable scope of this obligation. In practice, the prospects for conflict between the FET obligation and actions that the host state may want to take under the enumerated exceptions may be small.

Confidential information not required to be disclosed: This kind of exclusion is found in IIAs. Such an exception could also be included in the transparency provision and an example is provided in the sample transparency provision.[453] The exclusion in the sample exception provision is broader. It permits states to refuse to disclose

450 See Section 4.3 (Definitions).
451 See Section 5.6 (Limitations on expropriation and nationalisation).
452 See Section 5.6 (Limitations on expropriation and nationalisation).
453 See Section 5.10 (Transparency).

information that would impede law enforcement or would be contrary to the host state's law protecting government confidences, personal privacy or the confidentiality of the financial affairs and accounts of individual customers of financial institutions.

Reservations: The extensive categories of reservations against the national treatment and MFN obligations contemplated in the Canadian and US model agreements are reproduced in the sample provision as an example.[454] It may be that other kinds of reservations will be preferable for some states where their domestic policies require exemption from other IIA obligations. In addition, if commitments related to performance requirements, entry of personnel or the prohibition of restrictions on nationality requirements are included in an IIA, consideration should be given to whether the reservations should apply to these obligations too. The sample provision contemplates two categories of reservations to be listed by each party state in schedules attached to an Annex to the agreement: Annex I schedules will set out specific measures that are excluded; Annex II schedules will set out entire sectors or areas of public policy that are excluded. In addition, all sub-national measures are excluded.

With respect to the Annex I reservations for specific measures, the sample provision contemplates that each party state will set out in their respective schedules to the annex limitations on the national treatment and/or MFN obligations as those obligations apply to them. The sample provision obliges each party to accord to investors of the other party and their investments treatment that is no less favourable than provided for in their schedules. This approach follows the model in the *GATS*. To the extent that a state sets out the restrictions that currently exist in its national regime, this commitment amounts to a standstill, meaning that it commits states not to introduce further restrictions that are inconsistent with national treatment or MFN. A state could, however, set out limitations on its obligations in its schedule that allow restrictions on investment that are more onerous than its existing regime. To the extent that states do so, they may introduce new restrictions so long as they are permitted by the limitations on their obligations in their schedules.

An alternative approach would be to follow the US and Canadian models and provide that listed measures are not subject to the national treatment or MFN obligations and then go on to provide that any continuation or renewal of a listed non-conforming measure and any amendment that does not make the measure less consistent with national treatment and MFN is excluded from the application of the national treatment and MFN obligations as well. Under this approach, however, if a host state amends a non-conforming measure to make it more liberal regime or removes it altogether, the reservation does not permit the state to return to the less liberal approach that it previously maintained. For example, if a party state had listed a restriction on foreign ownership in a particular sector, such as hotels, in its Annex I schedule and then unilaterally removed the restriction, the Annex I reservation would not operate to permit the state to reinstate the restriction on foreign ownership in the hotel sector. The state's regime as liberalised by removal of the foreign ownership restriction would be subject to all of the obligations in the agreement. In this example, the national

454 See Section 5.3 (National treatment) and Section 5.4 (Most favoured nation).

treatment obligation might prohibit the reinstatement of the foreign ownership restriction. This is an example of the ratchet effect described above. In order to have flexibility on an ongoing basis to liberalise the rules in a particular sector and then return to a less liberal regime under this approach, it would be necessary for a host state to list the sector in its Annex II reservation schedule. In the sample provision, however, there is no ratchet that operates to increase the level of obligation for a state beyond what is expressly set out in its schedule to the annex. If a state changes its domestic regime to remove some permitted measure that discriminates against foreign investment, it retains the right to reimpose the measure.

Other exceptions in other parts of the Guide: In a number of other places in the Guide, exceptions have been included in relation to specific provisions.

- MFN – exceptions for past and future agreements of various kinds and dispute settlement procedures. See Section 5.4 (Most favoured nation).
- Expropriation – exception for compulsory licences of intellectual property rights. See Section 5.6 (Limitations on expropriation and nationalisation).
- Funds transfer – exceptions for measures related to law enforcement in various areas, for prudential measures and for balance of payments emergencies. The prudential measures exception in the funds transfer provision overlaps with but does not fully duplicate the general prudential measures exception. See Section 5.8 (Free transfer of funds).
- Transparency – exception permitting non-disclosure of confidential information. This exception overlaps with the general exception for confidential information in this section. See Section 5.10 (Transparency).

5.12.6 Sample provision: reservations for non-conforming measures

Reservations for Non-Conforming Measures

1. With respect to each Party, its Schedule to Annex I sets out the terms, limitations and conditions of its obligations under [Guide sample provision in Section 5.3 (National treatment)] and [Guide sample provision in Section 5.4 (Most favoured nation)]. Each Party shall accord investors of the other Party and their investments treatment no less favourable than specified in its Schedule.
2. [Guide sample provision in Section 5.3 (National treatment)] and [Guide Section 5.4 (Most favoured nation)] shall not apply to treatment accorded by a Party with respect to sectors set out in its schedule to Annex II.
3. In respect of intellectual property rights, a Party may derogate from [Guide sample provision in Section 5.3 (National treatment)] and [Guide sample provision in Section 5.4 (Most favoured nation)] in a manner that is consistent with its international agreements on intellectual property rights.
4. The provisions of [Guide sample provision in Section 5.3 (National treatment)] and [Guide sample provision in Section 5.4 (Most favoured nation)] of this Agreement shall not apply to:

a. Procurement by a Party or state enterprise; and

b. Subsidies or grants provided by a Party or a state enterprise, including government-supported loans, guarantees and insurance.

5. For greater certainty, [Guide sample provision in Section 5.3 (National treatment)] of this Agreement shall not apply to the granting by a Party to a financial institution of an exclusive right to provide activities or services forming part of a public retirement plan or statutory system of social security.

5.12.7 Sample provision: general exceptions

General Exceptions

1. Subject to the requirement that such measures are not applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors or a disguised restriction on investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures that are designed and applied:

   a. To protect human, animal or plant life or health;

   b. To protect internationally and domestically recognised human rights, labour rights or the rights of indigenous peoples;

   c. To ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; and

   d. To protect the environment, including but not limited to the conservation of living or non-living exhaustible natural resources.

2. Nothing in this Agreement shall be construed to prevent a Party from adopting or maintaining measures for prudential reasons, such as:

   a. the protection of investors, depositors, financial market participants, policy-holders, policy-claimants or persons to whom a fiduciary duty is owed by a financial institution;

   b. The maintenance of the safety, soundness, integrity or financial responsibility of financial institutions; and

   c. Ensuring the integrity and stability of the Party's financial system.

3. Nothing in this Agreement shall apply to non-discriminatory measures of general application taken by any public entity in pursuit of monetary and related credit policies or exchange rate policies.

4. Nothing in this Agreement shall be construed:

   a. To require any Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests;

   b. To prevent any Party from taking any actions that it considers necessary for the protection of its essential security interests:

i. relating to the traffic in arms, ammunition and implements of war and to such traffic and transactions in other goods, materials, services and technology undertaken directly or indirectly for the purpose of supplying a military or other security establishment,

ii. taken in time of war or other emergency in international relations, or

iii. relating to the implementation of national policies or international agreements respecting the non-proliferation of nuclear weapons or other nuclear explosive devices; or

a. To prevent any Party from taking action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security;

b. To prevent any Party from taking any measure necessary for the maintenance of public order.

5. Nothing in this Agreement shall be construed to require a Party to furnish or allow access to information the disclosure of which would impede law enforcement or would be contrary to the Party's law protecting government confidences, personal privacy or the confidentiality of the financial affairs and accounts of individual customers of financial institutions.

6. Nothing in this Agreement shall be construed to prevent a Party from taking *bona fide*, non-discriminatory measures to comply with international obligations under other treaties.

7. Subject to section 8, the provisions of this Agreement shall not apply to investments in cultural industries or to matters relating to taxation.

8. Nothing in this article applies to [Guide sample provision in Section 5.6 (Limitations on expropriation and nationalisation)] of this agreement, except that where an investor claims that a taxation measure involves an expropriation the investor may submit a claim to arbitration under [Guide sample provisions in Section 7.1 (Investor–state dispute settlement)] of this Agreement only if:

a. The investor has first referred to the competent tax authorities of both parties in writing the issue of whether that taxation measure involves an expropriation; and

b. Within 180 days after the date of such referral, the competent tax authorities of both parties fail to agree that the taxation measure is not an expropriation.