



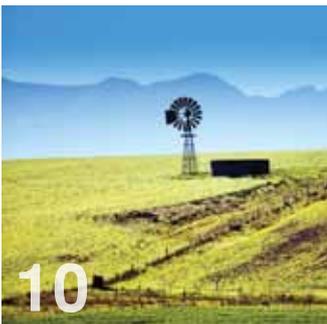
investmenttreatynews

A quarterly journal on investment law and policy from a sustainable development perspective

2010 midterm congressional elections in the United States:

Implications for new U.S. International Investment Agreements

by William Waren



Fairness and independence in investment arbitration: A critique of “Development and Outcomes of Investment Treaty Arbitration” by Gus Van Harten

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The International Institute for Sustainable Development
International Environment House 2,
Chemin de Ballexert, 5th Floor
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Tel +41 22 917-8748
Fax +41 22 917-8054
Email itn@iisd.org

President and Chief Executive Officer
Franz Tattenbach

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and European Representative of IISD
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Programme Manager
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Damon Vis-Dunbar

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2010 midterm congressional elections in the United States: Implications for new U.S. International Investment Agreements

William Waren

feature 1

The Republican victories in U.S. congressional elections on 2 November 2010 are widely assumed to have increased the odds that the Obama administration will proceed with new bilateral investment treaties (BITs) and free trade agreements (FTAs) containing investment chapters¹ such as the Trans Pacific Partnership (TPP),² as well as seek congressional approval of FTAs negotiated by the Bush administration with Colombia, Panama, and South Korea.³ Indeed, the conventional wisdom is that international trade and investment policy is one of only a handful of issue areas where President Obama and Republican leaders can forge a bipartisan deal resulting in congressional action.⁴ But these assumptions bear closer examination. The post-election situation is complex.



On the House side

Republicans gained control of the U.S. House of Representatives, including significant gains in states that have recently leaned Democratic. The House Republican leadership is in a good position over the next two years to seek ratification of the pending Colombia, Panama, and South Korea FTAs, which include investment chapters. Republicans are also in position to bolster the Obama administration's attempts to negotiate an investment chapter in a Trans Pacific Partnership (TPP) agreement.

The new Speaker, John Boehner of Ohio,⁵ the prospective chairman of the House Ways and Means Committee, Dave Camp of Michigan,⁶ and the likely chairman of the Ways and Means Subcommittee on Trade, Kevin Brady of Texas, are strong supporters of International Investment Agreements (IIAs). Brady's rise is particularly significant. He is an outspoken supporter of IIAs, in part because the results of international investment litigation lopsidedly favor the United States,⁷ and is likely to set the party line on IIAs for the House Republican leadership.

Moreover, the new Republican House leadership team is unlikely to face opposition to new IIAs within their own caucus comparable to what Democratic House leaders faced for the past three years. That said, the huge freshman class of Republican House members, including many Tea Party types, may be less disciplined than traditional Republicans and more concerned about loss of American sovereignty and anti-trade sentiment in their districts.⁸

As for the House Democrats, some members of the leadership, possibly including the Whip, Steny Hoyer of Maryland, and the likely ranking member on Ways and Means,⁹ Sander Levin of Michigan, may want to accommodate the White House and take a nuanced approach to investment and trade issues. But, rank and file House Democrats may be itching for a fight. The re-election of Nancy Pelosi, the feisty San Francisco Democrat, as party leader, despite the loss of over 60 seats in the election, suggests the caucus is in no mood to compromise in search of bipartisan deals. Although, it must be said that Pelosi, who participated in the so-called 2007 bipartisan trade deal, is not a rigid opponent of international trade and investment agreements.¹⁰

More members of the new Democratic caucus appear to be skeptical of trade and investment agreements. A Public Citizen analysis of the 2010 election results in House races shows that "Democrats who ran on fair trade were more likely to survive the GOP tidal wave than those that did not run on fair trade."¹¹

Some of these House Democrats may see political advantages in opposing new FTAs leading up to the 2012 elections, regardless of whether the agreements are supported by the Obama administration. The largely Democratic House Trade Working Group, led by Mike Michaud of Maine, was the core of successful opposition in the House to new FTAs over the past three years. Although the President has been reaching out to Michaud, there may be little incentive for the Working Group to back down now,

especially with polling that suggests that trade could be a wedge issue for Democrats in 2012.¹² Michaud, who made trade his signature issue, was reelected in Maine, even as the Republicans turned Maine's politics upside down by taking the governorship and both houses of the state legislature.

Michaud and the Trade Working Group are very clear about their views on international investment agreements. In 2009, Michaud sponsored, along with 133 House co-sponsors, the Trade Reform Accountability Development and Employment (TRADE) Act. It sets out in detail the Trade Working Group's vision for U.S. trade and investment policy, including the conditions that IIAs provide only for government-government dispute resolution and preserve the ability of each country to regulate foreign investment consistent with its own needs and priorities.¹³

The potential for conflict with the Obama administration is obvious. Lori Wallach, the director of Public Citizen's Global Trade Watch, who has a close relationship with the House Trade Working Group and Mike Michaud, has charged President Obama with flip-flopping on 2008 campaign promises to reform IIAs and warned that his support for a U.S.-South Korea trade pact and similar agreements threatens his 2012 reelection.¹⁴

Nonetheless, few House Democrats can relish the idea of a fight with President Obama going into 2012; maybe the Obama-Michaud conversation will lead to a compromise.

On the Senate side

The Democrats retain control of the Senate, even after losing six seats. Despite the loss of seats and the fact that Senate Democrats have always been more amenable to international trade and investment agreements than their counterparts in the House, it is still too soon to assume that IIA issues are settled for the new Senate.

“

If he seeks congressional approval of new or pending FTAs, President Obama will likely face significant opposition from members of the House Democratic caucus, which will be even more left-leaning and skeptical of globalization in 2011 and 2012.

”

With 22 Democratic seats to be contested in 2012 in 33 races,¹⁵ neither Republican nor Democratic leaders may be eager to have their members cast controversial votes on trade and investment measures that could tip the balance of party control. Harry Reid of Nevada, the Democratic Majority Leader, who is not always a friend of international trade and investment agreements, will have a lot to think about as he schedules Senate floor votes.¹⁶

The Republican Minority Leader, Mitch McConnell of Kentucky, flatly stated that his goal over the next two years is to focus on repealing health care and other measures passed by the previous Congress and to set the stage for defeating President Obama in 2012, not necessarily passing a lot of new measures.¹⁷ But, a few days later McConnell softened his remarks to say that the two sides might be able to work together on a few issues, including passage of the U.S.-South Korea FTA.¹⁸

The new ranking Republican on the Finance Committee, Orrin Hatch of Utah, may also be in an ambiguous political position. Hatch may face an even more conservative Republican opponent, connected to the Tea Party, for the 2012 Senate nomination, and for this reason may be reluctant to make common cause with Finance Committee Democrats.¹⁹ In addition, many Utah Republicans have concerns that IIAs could be used to challenge the state's prohibition on gambling and other public morals regulations.²⁰

Nonetheless, opponents of the current U.S. model for FTA investment chapters and BITs have reason to be concerned about the Senate. There is solid support for IIAs in the Republican Senate Caucus, while for the Democrats, opposition to IIAs in the Senate may be even weaker as a result of the departures of Senators Feingold, Dorgan, and Specter, all of whom were replaced by Republicans.²¹ However, there is more to the story.

Max Baucus of Montana, who is generally favorable to IIAs, but may stand in the way of the U.S.-South Korea FTA as long as cattlemen are dissatisfied, will remain chairman of the Finance Committee: the Senate's most important arbiter of international trade and investment proposals. He also supports BIT negotiations with China and others. However, Baucus is a transactional legislator who often puts his state's interests as his highest priority.²²

The chairman of the Finance Committee trade subcommittee will probably be Ron Wyden of Oregon once again, having handily won re-election. Like Baucus, Wyden is amenable toward, but not reflexively supportive of, FTAs.²³ Wyden cares about environmental issues and may be influenced by constituents at home who are concerned about the potential threat of IIAs to Oregon's environmental and land-use regulations.²⁴

Baucus, Wyden, and other members of the Finance Committee, however, will not be the only authoritative and persuasive voices among Senate Democrats when it comes to BITs.

Under the U.S. Constitution, the Senate alone must approve treaties, including BITs, with a two-thirds vote of members present.²⁵ Also, Senate rules give jurisdiction over treaty resolutions, including those pertaining to BITs, to the Foreign Relations Committee,²⁶ which will likely be chaired again by John Kerry of Massachusetts. In the course of Senate deliberations on the 2002 trade act, Kerry expressed concern about overbroad IIAs threatening domestic environmental laws and other forms of bona fide economic regulation in the public interest and offered an amendment on the floor. Although unsuccessful, this prompted the inclusion of the so-called Baucus-Grassley amendment, a milder measure directing the USTR to grant “no greater substantive rights” to foreign investors in new investment chapters.²⁷ Kerry reportedly is not ready to repeat the effort in order to seek additional protections for environmental and other regulations in future U.S. BITs, but it may be too soon for environmental advocates to write him off.

Conclusions

Even with Republicans gaining control of the House, uncertainties remain about the prospects for FTA approval over the next two years. On the Senate side, both Republicans and Democrats will be cautious about taking record votes on such controversial issues before the 2012 elections that will determine party control in the upper chamber. Also, if he seeks congressional approval of new or pending FTAs, President Obama will likely face significant opposition from members of the House Democratic caucus, which will be even more left-leaning and skeptical of globalization in 2011 and 2012. The odds are hard to calculate, but the strong support of the House majority leadership for approval of new FTAs surely will make some difference.

It is doubtful, on the other hand, that the odds for ratification in the Democratic-controlled Senate of new BITs have changed significantly as a result of the 2010 elections *per se*. In the past, “advice and consent” resolutions ratifying BITs, such as the 2006 measure approving the U.S.-Uruguay BIT, have been approved by the Senate with little controversy.²⁸ Therefore, Senate action on new BITs will probably have less to do with party control and more to do with how the negotiations with China, India, Pakistan, and others progress. The Obama administration is likely to finally make a decision on the provisions of a new U.S. model BIT as soon as it concludes consultation with congressional leaders, which at least allows formal BIT negotiations to proceed.²⁹

Yet many questions remain. Will the Senate get hung up on trade issues like beef exports, or environmental and labor standards? Will human rights abuses in Colombia or Panama’s status as a tax haven continue to complicate efforts to ratify those two FTAs? Will Speaker Boehner find his freshman class hard to discipline? Will House Democrats distance themselves from the President? Most important, how will the public react to new trade and investment deals?

Author

Bill Waren is policy director for the Forum on Democracy and Trade. For 17 years before assuming his current position, Bill closely studied the workings of the U.S. Congress in his role as federal affairs counsel for the National Conference of State Legislatures.

Notes

1 Pursuant to the “Bipartisan Trade Deal of 2007,” which facilitated House Democratic leadership support for the U.S.-Peru agreement despite objections from rank and file in the party caucus, President Bush included labor and environment protections in the Colombia, Peru, and South Korea FTAs. More relevant here, the 2007 deal also included a small reform of the investment chapter of the pending FTAs: the preamble of the investment chapters includes language stating that foreign investors will not be granted greater substantive rights with respect to FTA investment protections than those provided to domestic investors under domestic law. See M. Angeles Villareal, “The U.S.-Colombia Free Trade Agreement,” Congressional Research Service, October 1, 2010.

2 Negotiation of the Colombia, Panama, and Korea FTAs were conducted under so-called fast track or trade promotion authority provided by the Trade Promotion Act of 2002, which has now expired. Fast track authority provides for expedited congressional approval of trade and investment agreements, without amendment (although the details of implementing legislation are negotiated in advance with the Senate Finance Committee and the House Ways and Means Committee through a so-called mock mark-up process). Presumably if negotiations on the TPP are concluded before 2012, Obama will ask for fast track authority to facilitate its ratification. The likely reactions of congressional Republicans to such a request are hard to anticipate at this time.

3 President Obama in his January 2010 State of the Union Address stated that “...we will strengthen our trade relations with Asia and with key partners like South Korea, Panama, and Colombia...” “Text: Obama’s State of the Union Address,” *New York Times*, January 27, 2010, available at http://www.nytimes.com/2010/01/28/us/politics/28obama.text.html?_r=1&pagewanted=all. See also, J.F. Hornbeck, “The Proposed U.S.-Panama Free Trade Agreement,” Congressional Research Service, RL 32540, February 27, 2010; William H. Cooper, Mark E. Mangin, Remy Jurenas, Michaela D. Platzer, “The Proposed U.S. –South Korea Free Trade agreement (KORUS FTA): Provisions and Implications,” RL 34330, Congressional Research Service, July 2, 2010; Villareal *supra*. The Obama Administration is negotiating understandings with Panama on tax and labor issues, with Colombia on labor and human rights issues, and with South Korea on auto and beef trade in order to facilitate congressional approval of the three FTAs.

4 King and Spalding, “The Impact of the November 2 Elections on International Trade,” November 12, 2010 (“We will likely see the revival of certain free trade agreements and other pro-trade initiatives.”), available at <http://www.Kslaw.com/imageserver/KSPpublic/library/publications/ca111210.pdf>. Helene Cooper, “Obama Sails Trade Sea, Where Friends Are Foes,” *New York Times*, November 17, 2010; Peter Baker, “The Education of a President,” *New York Times Magazine*, October 12, 2010 (Rouse and Messina [Obama aides] see areas of possible bipartisan agreement like...passing long pending trade pacts...).

5 Boehner voted for the CAFTA, Australia, Singapore, Chile, and Peru FTAs. OnTheIssues, “John Boehner on Free Trade,” available at http://www.ontheissues.org/OH/John_Boehner.htm#Free_Trade.

6 Camp also has a record of strong support for FTAs. Camp, however, was concerned about the effect on the auto industry of the South Korea FTA. Committee on Ways and Means Republicans, Dave Camp, Ranking Member, "Chairman Levin and Ranking Member Camp Joint Statement on U.S.-South Korea FTA Negotiations," November 11, 2010, available at <http://republicans.waysandmeans.house.gov/News/documentsingle.aspx?DocumentID=214484>. The December 3, 2010 agreement between U.S. and Korea on supplementary provisions in the FTA related to autos addressed the concerns of Camp and U.S. automakers. Sewell Chan, "South Korea and U.S. Reach Deal on Trade," *New York Times*, December 4, 2010, p. B1.

7 According to Brady: "...the U.S. has used this [investor-state] successfully throughout the years to resolve disputes. California-based Metalclad successfully used NAFTA to challenge issues in Mexico. S.D. Meyers from Ohio, the same with Canada. We have had U.S. companies challenge bilateral investment trade issues in Poland to our benefit, Motorola in Turkey, Occidental in Ecuador, CMS and Sempira in Argentina, all using this provision to protect U.S. investors... But, if you look at the number of foreign investors who have used this process to successfully challenge the U.S., you will see a blank piece of paper, because it hasn't been done." Committee on Ways and Means, U.S. House of Representatives, 111th Congress, 1st Session, Transcript, Hearing on Investment Protections in U.S. Trade and Investment Agreements, May 14, 2009, available at <http://waysandmeans.house.gov/Hearings/transcript.aspx?NewsID=10394>.

8 King and Spalding, *supra* ("The position of the Tea Party members has not been fleshed out fully, but it appears that a slight majority of those elected are more likely to be against government intrusion and for free trade.").

9 It is unclear, at this writing, who is likely to be the ranking Democrat on the Trade Subcommittee of Ways and Means. The incumbent, John Tanner of Tennessee, declined to run for reelection.

10 After several FTAs, including the Chile, Singapore, and CAFTA agreements that were approved by only slim margins and in the face of increasing Democratic congressional opposition, the Bush administration negotiated a deal with Democratic as well as Republican leaders, and leaders of the House Ways and Means Committee and the Senate Finance Committee, in particular, to include some labor and environment protections and other provisions that would garner more Democratic support for future agreements. See, Office of the U.S. Trade Representative, Trade Facts, "Bipartisan Trade Deal," May 2007, available at http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset_upload_file127_11319.pdf. The House Trade Working Group strongly protested the deal. The next FTA to come before Congress, the U.S.-Peru FTA, did get substantially more Democratic support. But, the Colombia, Panama, and South Korea agreements are bogged down in controversy.

11 Todd Tucker, "TRADE Act Cosponsors Fared Better than Anti-Fair Traders," *Eyes on Trade*, November 11, 2010, available at <http://citizen.typepad.com/eyesontrade/2010/11/before-many-election-results-were-in-the-chamber-of-commerce-was-gleeful>. See also the complete analysis, "Election 2010: the Best Defense Was a Fair Trade Offense," available at http://www.citizen.org/documents/2010_election_Trade_report.pdf.

12 Pew Research Center for People and the Press, "Americans Are of Two Minds on Trade: More Trade, Mostly Good; Free Trade Pacts, Not So," November 9, 2010 ("The public wants increased trade with Canada, Japan and several other countries [China and South Korea being notable exceptions], but support for free trade agreements is at a 13-year low, and more say trade agreements have negative rather than positive impact on jobs, wages and economic growth."), available at <http://pewresearch.org/pubs/1795/poll-free-trade-agreements-jobs-wages-economic-growth-china-japan-canada>.

13 H.R. 3012, pp. 29-30, available at <http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.3012.JH>.

14 Lori Wallach, "2010 Election Focus on Trade and Offshoring Exposes Obama's G-20 Political Peril: Pushing Bush's Korea Trade Pact Endangers Obama's Reelection," available at <http://www.citizen.org/documents/G20%Korea%FTA%20Reporter%20memo.pdf>. See also, Public Citizen, "Selected Campaign Statements by President Barack Obama on U.S. Trade and Globalization Policy, 2008," available at <http://www.citizen.org/documents/ObamaTradeCampaignstatementsFINAL.pdf>.

15 Paul Steinhauser, "2012 Senate Battle Already Under Way," *CNN Politics*, November 5, 2010, available at <http://cnn.com/2010/POLITICS/11/05/senate.battle/index.html>.

16 Reid voted against the U.S.- Peru FTA, for example.

17 Manu Raju, "Mitch McConnell Doubles Down on President Obama," *Politico*, November 4, 2010, available at <http://www.buzzbox.com/top/default/preview/mcconnell-defeat-obama-in-2012?clusterId=23393258&id=12519759&topic=barack-obama%Aboehner>.

18 *Politics Daily*, "Mitch McConnell: Agreement with White House Possible on Some Issues," November 6, 2012, available at <http://www.politicsdaily.com/2010/11/06/mitch-mcconnell-agreement-with-white-house-possible-on-some-issues>

19 Steinhauser, *supra* (Republican senators up for reelection who could come up for attack by the Tea Party movement include Orrin Hatch of Utah...).

20 The author has spent considerable time in Salt Lake City discussing the relationship of IIAs to public morals regulation with members of the Utah legislature and members of the state's trade policy oversight commission.

21 In November of 2009, Senator Sherrod Brown of Ohio introduced the most-recent Senate version of the TRADE Act. His co-sponsors, all Democrats, included Byrd of West Virginia (deceased), Casey of Pennsylvania, Dorgan of North Dakota (retired), Feingold of Wisconsin (defeated in general election), Franken of Minnesota, Merkley of Oregon, Sanders of Vermont, and Specter of Pennsylvania (defeated in primary). Open Congress, "S. 2821 – TRADE Act of 2009," available at <http://www.opencongress.org/bill/111-s2821/show>. As another indicator of die-hard opposition to international trade and investment agreements among Senate Democrats, consider the roll call vote on the U.S. – Peru FTA of 77 yeas, 18 nays (including only one Republican), and 5 not voting. United States Senate, U.S. Senate Roll Call Votes, 110th Congress, 1st Session, on the Passage of H.R. 3688, available at www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=110&session=1&vote=00413.

22 See, United States Senate, Committee on Finance, "Baucus Comments on U.S. China Talks," available at <http://finance.senate.gov/newsroom/chairman/release/?id=8dfcd6a9-43e2-4975-970e-93dadcd7bf5>.

23 In the past, Wyden has voted for agreements that contain investment chapters, including the Central American Free Trade Agreement (CAFTA), which even Max Baucus voted against. He voted against FTAs with Chile, Singapore, and Oman, but for the U.S.-Peru FTA. OnTheIssues, "Ron Wyden on Free Trade," available at http://www.ontheissues.org/international/Ron_wyden_Free_Trade.htm.

24 Oregon Fair Trade Campaign, "Oregon Legislators Warn of Trade Deal's Threats to State Sovereignty," August 31, 2010 ("A bipartisan group of Oregon State Legislators sent U.S. Senator Ron Wyden (D-OR) a letter today urging him to use his position as chair of the Senate Subcommittee on International Trade to strip provisions from a pending trade agreement that threaten to expose Oregon laws to attack in international tribunals.")

25 U.S. Constitution, article II, section 2, paragraph 2.

26 U.S. Senate, Committee on Foreign Relations, "Committee Rules," 111 Congress, 1st Session, September 2009, available at <http://foreign.senate.gov/about/jurisdiction>.

27 The Kerry Amendment, No. 3430 to H.R. 3009, was tabled (rejected) by a vote of 55 to 41. Emergency Committee for American Trade, "Senate Trade Scorecard, 107th Congress, 2nd session, 2002," available at <http://www.ecatrade.com/keytrade/scorecard2.asp>.

28 U.S. Senate Committee on Foreign Relations, Legislative Activities Report, March 29, 2007, 110th Congress, 1st session, Report 110-40, p.3, p.7; Organization of American States, Foreign Trade Information System, "United States – Uruguay," available at http://www.sice.oas.org/TPD/URY_USA/URY_USA_eASP.

29 World Trade Online, "Hormats Says Administration To Seek Further Vetting With Congress On Model BIT," November 16, 2010, available by subscription only ("The Obama Administration plans to seek further consultations on a new model bilateral investment treaty [BIT] with the incoming Congress as part of its efforts to conclude an ongoing review that was to have been wrapped up late last year...").

Fairness and independence in investment arbitration: A critique of “Development and Outcomes of Investment Treaty Arbitration”

Gus Van Harten

feature 2

There has been recent interest in the use of quantitative research tools to evaluate the fairness and independence of investment arbitration. In this article, Professor Gus Van Harten critiques one of the most prominent studies to examine this question. While the study in question, “Development and Outcomes of Investment Treaty Arbitration” (Franck 2009),¹ has been used in some policy circles to support the argument that investment arbitration functions fairly, Van Harten argues it has limitations that prevent such conclusions.

Concerns about perceived bias

Investment treaty arbitration is unlike other forms of arbitration and international adjudication. It empowers arbitrators to make final decisions on public law and on important policy concerns. It raises issues of independence and impartiality that generally do not arise in other forms of arbitration.

In other contexts, both domestic and international, public law is decided finally by judges whose independence from state and private power is protected by institutional safeguards, including secure tenure, bars on outside remuneration, and an objective method of case assignment. The absence of these safeguards in investment treaty arbitration raises a reasonable perception in all cases that inappropriate factors have influenced a decision or award.

One set of possible influences arises from the financial and career interests of arbitrators who lack secure tenure and who engage in remunerative activities outside of the adjudicative role. Another arises from the potential influence of arbitral institutions and of private actors in the arbitration industry. Of course, the presence of these concerns does not explain fully the expected behaviour of arbitrators. One hopes and trusts that other considerations, values of fairness and integrity, will drive decisions.

The problem is that no one—other than the individual decision-maker—can know whether inappropriate factors have come into play. For this reason, the actual behaviour of arbitrators is not the sole concern. As important is the role of institutional safeguards in addressing reasonable perceptions of bias.

A final point is that openness is integral to independence and impartiality. Without openness, it is not possible to verify the fairness and integrity of a decision-making process. All empirical research on investment arbitration confronts this problem. At present, in some cases, we do not know who made the decisions, what decisions were made, and what policy concerns arose.² This fuels concerns about unfairness for the very reason that the process is being kept secret.

Comment on Franck (2009)

Empirical research can contribute, alongside deductive reasoning and doctrinal analysis, to the development of knowledge about investment law and its institutions. Yet empirical researchers must be clear about the questions they are examining and about the limitations and qualifications of their conclusions. These may seem like obvious points, but they are important to stress.

A number of studies have reported on outcomes in known investment arbitrations. Some commentators have relied on such data to advance claims about the actual performance of arbitrators. Many of the studies to date, however, do not examine specific hypotheses of bias or position the study in terms of literature on institutional aspects of adjudicative independence. Existing studies also face serious methodological constraints and depend on assumptions that heavily qualify results.³ As such, one should be very cautious about using such studies to draw conclusions about the actual behaviour of arbitrators.

A few studies have sought to analyze specific hypotheses of possible bias on the part of investment arbitrators. They have focused on actual bias (usually at a systemic level) as opposed to reasons for perceived bias. The study by Franck is probably the most prominent.⁴

Outline of the study

In the study, Prof. Franck examined hypotheses arising from individual factors that could generate actual bias in investment arbitration. These factors involved possible arbitrator prejudices tied to their nationality and/ or to characteristics of the respondent state. Both of these factors were grouped according to the “development status” of arbitrators based on their nationality and respondent countries, and then compared to outcomes in specific cases.

Franck’s hypothesis was that development status would not affect outcome and “that arbitrators can make decisions neutrally on the basis of the facts and law”.⁵ The study design tested only the first element of this hypothesis, but was evidently intended to provide a basis for comment on the second.

To test the hypothesis, Franck analyzed outcomes in 52 treaty cases with publicly-available information. She applied two metrics to classify the development status of the presiding arbitrators and respondent states. The first metric was OECD membership. Arbitrators and countries were treated as “developed” if they (or their countries of nationality) were members of the OECD and as “developing” if they were non-members. Second, the study classified arbitrators and countries based on the World Bank income classification system.⁶

Based on this analysis, the study did not find significant variations between outcomes linked to the development status of presiding arbitrators and respondent countries. In turn, Franck drew some bold conclusions about the integrity and fairness of investment arbitration.

Franck’s outline of her methodology is commendable for its clarity and transparency. However, the study has limitations and, in some cases, important flaws. Most important is the extent to which Franck over-stated or mis-stated key conclusions. The following are examples, drawn from the main text, conclusion, or abstract of the study.

In the main text regarding the comparison of development status to win/ loss outcomes, it is stated that the study “offers a powerful narrative that there is procedural integrity in investment arbitration”.⁷

In the main text regarding the comparison of development status and amount-of-damages outcomes, it is stated that the “lack of a main effect for a respondent’s development status stands in sharp contrast to the assertions that investment treaty arbitration unfairly privileges the developed world or improperly harms the developing world.”⁸

In the study’s conclusion it is stated:

“The notion that outcome is not associated with arbitrator or respondent development status should be a basis for cautious optimism. It provides evidence about the integrity of arbitration and casts doubt on the assumption that arbitrators from developed states show a bias in terms of arbitration outcomes or that the development status of respondent states affects such outcomes. It suggests that major structural overhaul may not be necessary because it is not clear that arbitration is inherently predisposed towards particular

outcomes.”⁹

In the study’s abstract it is stated:

“The results demonstrate that, at the macro level, development status does not have a statistically significant relationship with outcome. This suggests that the investment treaty arbitration system, as a whole, functions fairly and that the eradication or radical overhaul of the arbitration process is unnecessary.”¹⁰

For the reasons outlined below, these statements, to varying degrees, are exaggerated or misplaced.

Limitations of the OECD metric

An initial limitation of the study relates to the use of the OECD metric. The equation of OECD membership with developed status makes it likely that OECD countries that are reasonably classified as developing or transition countries (Mexico, Turkey, and the former East Bloc OECD countries) were classified as “developed”. This raises the prospect of a misclassification of the development status of arbitrators or countries in the data.

This limitation would not be serious if it were communicated clearly and transparently by the researcher. However, Franck did not identify this limitation of the OECD metric in her study. She also did not attempt to indicate whether and how the findings might vary if the data was broken down in order to separate developed OECD countries from developing/ transition OECD countries.

I examined Franck’s data in order to determine whether accounting for this aspect of the OECD metric affected the results. This was done by distinguishing Mexico, South Korea, and the former East Bloc countries from other OECD members.¹¹ The review confirmed that this limitation of the OECD metric affected significantly the study’s results. In particular:

In the 49 cases reviewed by Franck using the OECD metric, all 36 of the presiding arbitrators who were nationals of an OECD country were nationals of a “developed” OECD country. This included arbitrators from 13 countries: United Kingdom (6 cases), Sweden (5), Australia (4), Germany (4), USA (4), Switzerland (3), Canada (2), France (2), Spain (2), Denmark (1), Greece (1), Italy (1), and the Netherlands (1).

Of the 36 tribunals with a presiding arbitrator who was a national of a developed OECD country, 10 decided cases against a developing or transition OECD country (including seven cases against Mexico, two against the Czech Republic, and one against Slovakia).

Of the 13 tribunals with a presiding arbitrator who was not a national of an OECD country, one decided a case against a developing OECD country (Mexico).

Accounting for the heterogeneity of OECD membership, then, 10 cases should have been classified as developed-to-developing or developed-to-transition arbitrations rather than as developed-to-developed arbitrations. Also, one case should have been classified as a developing-to-developing rather than a developing-to-developed arbitration.

Thus, in Franck’s study, 11 of the 49 cases were arguably misclassified. Further, by accounting for the heterogeneity of OECD membership, the ratio of developed to developing respondent countries in Franck’s data dropped dramatically from a ratio of 18 to 31 to a ratio of seven to 42.

The limitations of the OECD metric are not the critical point here. The key issue is the lack of transparency about a methodological limitation that undermines the validity of the study. As outlined, use of the OECD metric arguably led to a misclassification of 22% of cases. But the study does not highlight this concern to the reader

or attempt to examine how it affected the results.¹²

Collapsing of the World Bank metric

A second limitation involved the World Bank income classification metric that was used by Franck to measure development status. This limitation arose from a lack of data.

Franck sought to compare income levels of the countries of nationality of presiding arbitrators to the income levels of respondent states. As such, there were 16 boxes in which the study required data in order to test her hypotheses using the 4-level World Bank metric. However, Franck did not have enough data to do this. First, there were no cases at all decided by presiding arbitrators from low income countries; thus, four of the 16 boxes in Franck’s analysis contained no data. Second, there was only one case that was decided by a presiding arbitrator from a lower middle income country.

In response to this lack of data, Franck collapsed the 16-box grid into an 8-box grid.¹³ In turn, all but one of the cases decided by a “developed country” presiding arbitrator involved arbitrators from upper-middle income countries. Franck was transparent about the need to collapse the World Bank metric. This allows the reader to see that the World Bank metric was frustrated by a lack of data.

On the other hand, the limitations of the World Bank and the OECD metrics highlight that the study tested only very narrow aspects of questions about possible bias, let alone fairness and independence, in investment arbitration. Specifically, the study relied on a limited data pool to test whether there was a connection between nationality groupings of arbitrators or countries and particular outcomes. Regardless of its results, the study could not provide a “powerful narrative” either for or against the procedural integrity of the system or support conclusions on whether the system “functions fairly”. Far more information involving a wide range of factors would be required to contemplate such claims.

Lack of data and corresponding risk of error

A major limitation of the study is common in empirical work on investment arbitration. This is the lack of data, which in turn raises concerns about reliability.

The lack of data in this case frustrated the drawing of reliable conclusion to support or refute Franck’s hypothesis that development status would not affect outcome.¹⁴ Indeed, the only clearly-supported conclusion of Franck’s study was that there was insufficient data to test her hypothesis with an acceptable level of reliability. This lack of reliability affected all four of the metrics employed by the study.

A claim of statistical significance about a hypothesized connection (or lack of connection) between variables requires sufficient data to remove any significant risk that the apparent relationships are explained by chance. Franck calculated that the number of awards needed to generate statistically significant findings (on her standard, findings that carried a 20% chance of error). Depending on the metric and the effect size of the results, between 382 and 781 awards were required for most of Franck’s comparisons.¹⁵ Yet the available sample sizes were between 47 and 49 awards.

This led to a 40 to 80% chance of error (so-called “Type II error”, referring to the risk of a false negative) in Franck’s results. As a result, there was insufficient evidence of either the presence or absence of a statistically significant connection between development status and outcome. Findings or conclusions beyond this, based on the results, lack reliability due to the high risk of error.

It was rigorous and transparent for Franck to provide these

calculations on the risk of error and to indicate the corresponding limitations. But these issues were reported only in a series of footnotes and, in some instances, tangentially in the main text.¹⁶ Importantly, Franck did not mention the high risk of error underlying the bold claims reproduced above.

More fundamentally, the study relied on the risk of error associated with a hypothesized connection between development status and outcome in order to convey that there was in fact no connection between development status and outcome.¹⁷ The latter does not necessarily follow from the former. The more appropriate conclusion to draw was that there was insufficient data to test the hypothesis that development status would not affect outcome.

For these reasons, Franck's results do not establish that "development status does not have a statistically significant relationship with outcome", for example, as was claimed. Development status may or may not affect outcome; based on Franck's study, we do not know with a reasonable degree of reliability. Likewise, the high risk of error should have precluded Franck from reporting that "outcome is not associated with arbitrator or respondent development status".

Failure to account for alternative explanations

In empirical research, there is typically a range of alternative explanations for results. It is important for a researcher to convey clearly that such alternatives exist and to avoid undue emphasis on one or a small number of possible explanations.

However, Franck emphasized only a limited set of explanations for her results—such as the prospect that the system functions fairly—while neglecting others. One alternative explanation, for example, is that arbitrators do not make decisions based on nationality, but rather based on their membership in a common culture or industry of arbitrators. Another is that the facts of cases involving some classes of countries are more favourable to investors than the facts of cases involving other countries, and that factual differences will lead to variations in outcome.

Even assuming that her results were reliable, it was an over-reach for Franck, in light of alternative explanations, to draw conclusions on the "integrity of arbitration", on whether the system "functions fairly", or on whether there is need for a "major structural overhaul". A wide range of institutional and individual concerns about potential bias were simply not tested by the study.

Conclusions

These issues and concerns do not raise problems with the empirical method itself, but rather with the way in which the method was employed in Franck's study. Many of the limitations of the study could have been avoided with greater transparency and caution on the part of the researcher in the statement of conclusions.

The fundamental problem is the way in which Franck constituted and presented her conclusions. The key problems are:

- the claim that a lack of reliable evidence of a connection between nationality and outcome demonstrated the absence of such a connection,
- the failure to make clear that the lack of data precluded the study's hypothesis from being tested reliably, and
- the failure to highlight alternative explanations for the results in statements of the conclusions.

This discussion highlights how important it is for a researcher to present findings and conclusions accurately and with care. Otherwise, there is a danger that policy makers will take up a study for purposes that the research does not support, as has

happened in the case of Franck's work.¹⁸

Most importantly, it would be a mistake to rely on quantitative methods to address perceived bias in adjudication. Absent an admission by the decision-maker, it is not possible to show definitively whether inappropriate factors have affected a particular decision or award. This explains why it is critical for the institutional structure of adjudication to allay concerns about the financial or career interests of adjudicators, regardless of whether or not these factors are affecting actual decisions. The priority is not to seek definitive proof or dis-proof of actual bias but rather to anticipate and address the uncertainties that give rise to reasonably perceived bias. At the institutional level, this calls for the incorporation of well-known safeguards of judicial independence in order to support public confidence in the fairness of adjudication.

Author

Gus Van Harten is Associate Professor at the Osgoode Hall Law School, York University, where he teaches Administrative Law, International Investment Law, and Governance of the International Financial System.

Notes

1 S.D. Franck, "Development and Outcomes of Investment Treaty Arbitration" (2009) 50 *Harvard International Law Journal* 435. Further methodological background to this study was provided in S.D. Franck, "Empirically Evaluating Claims About Investment Treaty Arbitration" (2007) 80 *North Carolina Law Review* 1.

2 This is especially true for arbitrations conducted in private forums such as the International Chamber of Commerce.

3 For example, data on outcomes is typically drawn from ICSID, because of the relative openness of ICSID proceedings, and may say little or nothing about other forums. Also, data on outcomes as a measure of actual performance is open to a range of alternative explanations, such as variations in the strength of parties' claims, diversity of fact situations, possible inflation by claimants of amounts claimed, procedural variations among forums, varying experience levels and incentives among arbitrators, and varying political influences of states and private actors. Existing data on outcomes also does not capture aspects of tribunal decisions – such interpretations of the law – that may reflect bias independently of outcome. It is also very difficult, if not impossible, to identify the "appropriate" or "fair" spread of outcomes against which actual outcomes are to be measured. Lastly, cumulative data on outcomes does not explain whether the outcome in any particular case was influenced by inappropriate factors. As such, there will always remain a basis for perceived pro-investor or pro-state bias in specific instances based on inadequacies of the institutional structure. This is the concern that institutional safeguards of independence are meant to address.

4 Franck (2009), above note 1.

5 Franck (2009), above note 1, p. 454.

6 The World Bank income classification system divides countries, based on Gross National Income per capita, into four categories: high income, upper middle income, lower middle income, and low income. In classifying outcomes, Franck characterized as a win for the respondent state an award of no damages against the state. She treated as a loss an award of any amount in excess of zero damages against the state. Second, Franck evaluated outcome in terms of the amounts of money awarded in cases where the claimant was successful. Due to limitations in the available data, Franck's sample was reduced to outcomes in 49 cases for the OECD metric and 47 or 49 cases (depending on whether a win/ loss or total damages outcome was being measured) for the World Bank metric.

7 Franck (2009), above note 1, p. 464.

8 Franck (2009), above note 1, p. 470.

9 Franck (2009), above note 1, p. 487.

10 Franck (2009), above note 1, p. 435.

11 I examined OECD membership in 2009, which was the year of publication of Franck's study. Thus, Chile, Israel, and Slovenia – which joined the OECD in 2010 – were characterized as non-OECD members for purposes of this review of Franck's data.

12 Note that this criticism of the OECD metric was conveyed to Professor Franck prior to publication of her 2009 study, above note 1. Other criticisms laid out in this article were not conveyed until after publication of the study.

13 Franck (2009), above note 1, p. 459.

14 Franck (2009), above note 1, p. 454.

15 Franck (2009), above note 1, p. 461-70.

16 Franck (2009), above note 1, p. 461-70.

17 Franck (2009), above note 1, p. 460-62.

18 See the separate statement by a member of the U.S. Model BIT Review committee, Mark Kantor, who cited Franck's conclusion on development status and outcome in support of his position against reform of the U.S. Model BIT. United States, Report of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty (30 September 2009), Annex B (Particular Viewpoints of Subcommittee Members), Statement of Mark Kantor, p. 28-9.

A Global Thirst: How water is driving the new wave of foreign investment in farmland

Carin Smaller



It is no longer a secret that there is a new wave of foreign investment in farmland, predominantly in Africa. An explosion of media reports and a series of studies by the World Bank, Food and Agricultural Organisation (FAO), International Fund for Agricultural Development (IFAD), United Nations Conference on Trade and Development (UNCTAD) and International Institute for Environment and Development (IIED), have confirmed the scale and consequences of this new influx of foreign investment. The World Bank report, by far the most comprehensive, found that reported deals amounted to 45 million hectares in 2009 alone.¹

That is compared with an average land expansion rate of 4 million hectares a year in the decade leading up to 2008. The top four targets for investors were Sudan (4 million hectares), Mozambique (2.7 million hectares), Liberia (1.6 million hectares) and Ethiopia (1.3 million hectares).

After decades of neglect, rural areas and the agriculture sector desperately need investment. However, not all foreign investment contributes to development nor increases employment. In fact, the World Bank report found that investors targeted countries with weak land governance, resulting in land transfers that often neglected existing land rights. All the reports pointed to a culture of secrecy in which communities, and even government officials, were not consulted or informed about land deals until after they had been signed. The World Bank also found that investment projects failed to generate employment.

The motivation for this new wave of investment is strongly driven by water. States with scarce or depleted water resources are looking to outsource their water use by growing crops abroad, and private investors are seizing the opportunities. At a recent investor conference in Geneva, Switzerland,² water was one of the key issues on the agenda. Neil Crowder from Chayton Africa, an investment fund, said, "in Africa the value is not in the land. Water is the key aspect for what we are looking for with our investments." Judson Hill from NGP Global Adaptation Co, a private equity fund, said, "when a country imports one ton of wheat it is saving about 1300 cubic meters of domestic water."

In an article in the Foreign Policy journal, the chairman and former CEO of Nestle, Peter Brabeck-Letmathe, called it "the great water grab." He wrote: "purchases weren't about land, but water. For with the land comes the right to withdraw the water linked to it, in most countries essentially a freebie that increasingly could be the most valuable part of the deal."³

Nestle's statement captures the essence of the problem: that so-called "land grabs" are in fact "water grabs." Why? First, because the countries pursuing farmland investments are deeply concerned about domestic water scarcity as a result of agriculture production. Second, and more importantly, because the current global regime of investment treaties and host government agreements provide foreign investors with the legal guarantee needed to safeguard and operationalise their investment (and to take states to international arbitration if they do not honour contracts.) Yet, in many of the countries

experiencing an influx of foreign investment in agriculture, these protections for investors are not counter-balanced with adequate domestic regulations to safeguard the land and water rights of citizens. When it comes to agriculture, land is only a small part of the equation. Water is the key ingredient to operationalise agricultural investments. Without water, the land has absolutely no value to the investors.

Putting water into the equation

Agriculture is by far the most water-intensive activity. Close to 70 percent of all freshwater appropriated for human use goes to agriculture. In the last century, while the world population has tripled, water use has been growing at more than twice that rate.

Increased agricultural production for biofuels has also put pressure on water resources. In 2008, more than one-third of maize production (one of the most water-intensive crops) in the United States was used to produce ethanol and about half the vegetable oils produced in the European Union were being used for biodiesel.⁴

An increasing number of regions are chronically short of water. By 2025, 1.8 billion people will be living in countries or regions with absolute water scarcity, and two-thirds of the world population could be under conditions of water stress. Climate change is expected to account for about 20 percent of the global increase in water scarcity.

According to the FAO, water shortage is probably the single most important problem facing China's agriculture today and may affect 36 percent of China's grain production.⁵ Saudi Arabia is rapidly depleting its non-renewable water resources despite the fact that it already imports 70 percent of the country's food needs. Even in Europe, which is considered to have adequate water resources, water scarcity and drought is now more frequent and widespread.⁶

Investing in water abroad

It is no surprise, therefore, that there is a strong correlation between the countries looking to preserve their water resources at home and the investors who are leasing farmland abroad, including private and state-owned investors from the United States, European Union, Japan, Gulf states, China, Korea and India.

A US-based pension fund TIAA-CREF, for example, has US\$2 billion allocated for farmland investment.⁷ The Singapore-based Duxton Asset Management has raised US\$330 million. The London-based Agrifirma Brazil has raised US\$179 million.⁸ In January 2009, Saudi Arabia launched the King Abdullah Agricultural Initiative, a government-sponsored investment fund, backed by US\$800 million, to help private Saudi businesses invest in agricultural projects.⁹ The Saudi Minister of Agriculture, Fahad Abdul-Rahman Balghunaim, said "the country is now giving priority to water security over food security... this was a cabinet decision, which also directed us to stop producing wheat locally."¹⁰

Does Africa have abundant water supply?

Two-thirds of reported land deals have taken place in Africa because of the perceived abundance of fertile land, water and natural resources. According to the FAO, Africa uses barely 5.5 percent of its renewable water resources, and only two percent of its freshwater resources for irrigation. The FAO estimates the irrigation potential of the continent at more than 42.5 million hectares of land.

But while parts of Africa have significant water resources, of the estimated 800 million people who live on the continent, more than 300 million live in a water-scarce environment.¹¹ Only 64 percent of the population has access to improved water supply, the lowest coverage of any region in the world. The situation is much worse in rural areas, where access to improved water supply is only 50 percent compared with 86 percent in urban

areas.¹² Some farmers only grow one or two kinds of crops and risk starvation if not enough rain falls. The projections for climate change show that by 2050 the African continent will face a decrease in the amount of rainfall, a rapid increase in soil erosion and increased desertification.

African governments are responding to this crisis, but the new wave of foreign investment could undermine these efforts.¹³

The consequences of international investment law

The scale and nature of the current wave of investment increases the potential to shift rights from domestic to foreign actors and to undermine local communities' access to land and water. This is because of the current frameworks of domestic and international investment law. In many of the states where farmland investments are taking place, there is either no, insufficient or vague domestic law concerning land and water rights. On the other hand, the international investment-law framework provides hard contractual rights to protect foreign investors. Where this happens, prior land and water users may have no legal recourse while investors will have contractual rights to fall back on, enforceable under an international dispute settlement mechanism.

Some of the key provisions enabling foreign investors to secure water rights when they invest in land are as follows:

1. Investment treaties often include a standard of **fair and equitable treatment**. This standard contains the concept of a "legitimate expectation" of the investor to secure not only title to the investment but also rights to maintain its operations, for example to draw water for agricultural purposes. This international law right could provide a secured right to foreign investors, even if it conflicts with existing or future local water needs.
2. Investment treaties include a **prohibition against expropriation without compensation**. The issue of compensation is murky when certain rights for operating an enterprise are reduced but not fully taken away. This is a foreseeable situation in relation to farmland investments, all of which rely upon the availability of water, and many of which are for 50-99 year lease periods. If water resources drop to a level below the requirements of the investment, the host state will not be able to do much and compensation could not be foreseeable. However, if there is sufficient water available, but the amount allocated to the investor is reduced to meet the needs of other users, reducing water allocations to the investor may be defined by a tribunal as an expropriation of the right to operate the business.¹⁴
3. Investment treaties may include **pre-establishment rights** (or liberalisation commitments), which means foreign investors must be treated the same as domestic investors, including being allowed to purchase land and access water on the same terms.
4. Investment contracts between the state and the investor may contain a **stabilization clause**, which will enable the investor to avoid complying with, or be entitled to compensation, when new regulations come into force, for example environmental measures to reduce pollution or to protect against runoff of pesticides and fertilizers.
5. Finally, almost all investment treaties today include a **dispute settlement mechanism** to allow foreign investors to challenge governments if there are any changes that substantially affect an authorized foreign investment and its profit levels. Where rights to water are granted, any changes to those rights could trigger an investor-state arbitration.

Conclusion

If governments are interested in using their natural resource base to achieve sound economic development, it is essential to

have a strong set of domestic laws to protect land rights, water use, environmental regulations and labour rights. International investment agreements protect the rights and interests of foreign investors. Domestic laws to protect the rights and interests of individuals and communities are vital to ensure a level playing field.

An often-identified approach to improve the development impacts of host government agreements is to include certain requirements on investors to contribute to the local community in economic and social terms. These can include hiring a designated number of local workers, purchasing a percentage of local inputs, providing technology transfer and training, minimum levels of contract farming, selling a percentage of production to local markets, building schools, houses and medical clinics, and other requirements which can guarantee a positive impact locally.¹⁵

Host government agreements should also provide for periodic reviews of water rights and allocations for investors so as not to undermine citizens' access to water. In addition, host government agreements should not undermine the ability of government to introduce new domestic regulations that serve the public interest, for example pollution controls, or banning certain chemicals to protect human health.

For foreign investment to benefit poor countries, it must be part of a broader development strategy, including improved water management. The current wave of investment is operating in a vacuum and can easily undermine development goals. If governments can shape the current investor-frenzy to feed into existing agricultural and rural development strategies, they will be able to transform decades of neglect into an engine of growth.

Finally, processes that seek to value land for the purpose of foreign investment must fully account for the value of the water. It is unacceptable that foreign corporations can, in the words of Mr Brabeck-Letmathe, "essentially [receive] a freebie that increasingly could be the most valuable part of the deal" while developing countries give away the world's most valuable resource.

Author

Carin Smaller is advisor to the International Institute for Sustainable Development (IISD) where she specializes on issues related to agriculture and investment. She is former head of the Geneva office for the Institute for Agriculture and Trade Policy (IATP) where she assisted developing country governments in the WTO negotiations on agriculture. She holds a Bachelor of Laws and a Bachelor of Arts in development studies.

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⁹ John Stakianakis, Turki A. Al Hugaif and Daliah Merzaban, Saudi Arabia Economics - Pressure on Prices, Banque Saudi Fransi, August 2010

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¹² African Union, Water for Agriculture in Africa, Ministerial Conference on Water for Agriculture and Energy in Africa: The Challenges of Climate Change, December 2008

¹³ In 2002, NEPAD's Comprehensive African Agriculture Development Programme (CAADP) offered a framework for investment in agriculture in Africa, with special emphasis on water control. In Maputo, in 2003, the Heads of State and Governments of the African Union committed themselves to allocating at least 10 percent of their national budgetary resources for agriculture and rural development. In 2004, the Sirte Declaration focused on ways to implement integrated and sustainable development of agriculture and water in Africa.

¹⁴ Carin Smaller and Howard Mann, A Thirst for Distant Lands: foreign investment in agricultural land and water, IISD, May 2009

¹⁵ *ibid.*

UNCTAD's 2010 World Investment Forum: High-level experts discuss investment policies for sustainable development

James Zhan



The 2010 World Investment Forum (WIF), held on 6-9 September 2010, in Xiamen, China, turned UNCTAD into the global gravity center for open, universal, inclusive and high-level international investment discourse and policy formation. Eight events and conferences were attended by more than 1,800 participants from 120 countries and 16 international organisations, among them nine heads of State, four heads of international organisations, 79 ministerial-level officials, and 116 senior business executives. Stakeholders from all corners of the investment community gathered at the event to discuss how to harness international investment for sustainable development.

Investing in sustainable development

Under the overall theme of “investing in sustainable development”, eight meetings at the 2010 World Investment Forum allowed experts to share experiences and offer their forward-looking insights. The second WIF¹ brought together investment policy makers and negotiators, investment promotion agencies, key market participants at stock exchanges (e.g. investors, exchanges and regulators), policy makers in the field of finance and sovereign debt (including representatives of multilateral financial institutions), as well as academia, the private sector and civil society at large. Taking a comprehensive approach to the many facets at the interface between investment and sustainable development, the WIF's eight meetings explored a specific angle to the challenge of making investment work for sustainable development.

Eminent speakers at the WIF's opening ceremony included the Secretary-General of the United Nations (via video message), the President of Iceland, the Prime Minister of Mozambique and the Vice-President of China, who all stressed the important role of private investment in addressing the challenge of global warming, promoting sustained economic recovery and achieving the Millennium Development Goals (MDGs). At the World Leader's Investment Summit, heads of State and Chief Executive Officers (CEOs) of major global companies stressed the need for private investment as an engine of growth, highlighting its critical role in overcoming the multiple crises of food, energy and the economy.

In the High-Level Tripartite Conference, which brought together CEOs, senior government officials and heads of investment promotion agencies, participants agreed on the important role investment has for combating climate change and on the need to harness attendant opportunities. Participants highlighted the importance of adequate policies for green market creation, public private partnerships and the need for talent in developing

countries. The 2010 Sustainable Stock Exchanges event focused on the relationship between major exchanges and the regulatory frameworks in which they operate in light of environmental, social and governance issues. High-level stock market regulators, along with leading stock exchange executives, and CEOs explored how stock exchanges could cooperate with investors, regulators and business to encourage responsible long-term approaches to investment. The 8th meeting of UNCTAD's International Investment Advisory Council stood under the theme of “investing in the poor (viable and sustainable investment in poverty alleviation), for the poor (accessible and affordable products and services) and with the poor (fostering business linkages with domestic SMEs)”. The Conference on Sovereign Lending and Borrowing reviewed a first working draft of a set of principles for promoting responsible sovereign lending and borrowing, and discussed how to set up a transparent and inclusive process for further work in this area under the auspices of the UNCTAD.

International and national investment policy

Within this broader context of the WIF, the Ministerial Roundtable and the International Investment Agreements (IIA) Conference 2010 stand out in specifically addressing international and national investment policies. The half-day Ministerial Roundtable involved 26 ministerial-level officials dealing with investment and development, one head of State, as well as Dr. Supachai Panitchpakdi, Secretary-General of UNCTAD, and Mr. Pascal Lamy, Director-General of the World Trade Organization (WTO). The full-day IIA Conference 2010 brought together 223 IIA experts from 80 countries—among them six ministers and two heads of international organizations. This wide participation and the global nature of the meeting highlights UNCTAD's role as focal point for intergovernmental exchanges on issues related to investment and sustainable development.

Discussions on investment policy focused on a number of interrelated areas: (i) how to complement policies aimed at attracting investment with policies that help ensure sustainable development benefits from such investment (e.g. how to improve the interaction between the investment regime and other public policy areas); (ii) how to enhance coherence within the investment regime (e.g. coherence between international agreements and coherence between international and national investment policies); (iii) how to handle the issue of investor-State dispute settlement (ISDS); and (iv) how to harness international cooperation as a tool to address the challenges ahead?

Interaction of investment policy with other bodies of law

Attracting investment is not an end in itself, but a means towards achieving sustainable development. At the Ministerial Roundtable, speakers not only shared experiences and best practices regarding their countries' efforts to attract foreign investment and the benefits they expect from it. Ministers also agreed that investment policies have to be developed in tandem with other important policies in order to achieve development benefits. This includes policies for ensuring benefits for the poor and marginalized within a society; social, health and education policies; employment and labour market policies; industrial policies; environmental policies; health and labor standards; science and technology policies; corporate social responsibility initiatives; and competition policies—hence requiring effective coordination among national ministries with responsibilities in these individual areas. The key lies in finding the appropriate balance between rights and obligations of investors and host States. Strong institutions and skilled human capacity are of fundamental importance in this context.

Similarly, international investment policy cannot be seen in isolation. Most of today's challenges are global and involve a variety of different legal and policy regimes that interact and

overlap. Increasingly, the climate change, environmental, national security, finance, trade and human rights regimes interact with an expanding international investment regime that in itself places increasing importance on public policy concerns. Many IIAs already concretely include provisions on environment and climate change (see UNCTAD's 2010 World Investment Report)², health, safety and labor standards, and financial issues. At the same time, the predictability, stability and credibility of the relevant legal and policy regimes matter for investors in their search of attractive business destinations.

At the IIA Conference, participants discussed this key challenge of preserving space for governments to regulate in the public interest and in support of domestic development priorities. Whether justified or not, investors may seek compensation from governments for the violation of the fair and equitable treatment standard or indirect expropriation, resulting from such policies. Accordingly, states have increasingly adopted policies to counter such risks and protect the public interest.

Carefully crafting IIAs so as to ensure appropriate policy space

There are numerous tools that governments can use to address concerns that investment policies may unfavorably affect legitimate public interests. Amongst the approaches discussed were the exclusion of specific sectors or policies from an IIA's liberalization or pre-establishment commitments and the inclusion of general (or issue-specific) exceptions. The process of investment liberalization in itself at times requires adjustment mechanisms, and there is a need for proper pacing and sequencing of economic, fiscal and other policies in line with underlying economic and developmental conditions. Temporary controls and "state of emergency" exceptions are also increasingly common in IIA provisions to safeguard against situations of severe stress to the society, the economy, the financial system or national security.

Vis-à-vis the potential of protectionism

According to experts, providing for such safeguards and exceptions is legitimate and highly recommendable, though they have to be used with care and should not result in investment protectionism. The threat of investment protectionism was also addressed at the Ministerial Roundtable, where ministers noted that so far, countries have largely resisted protectionist pressures—a statement in line with the findings of UNCTAD's work on national and international investment policies.³ UNCTAD's most recent report on G20 investment measures (prepared jointly with the OECD) and submitted to the G20 Summit in Seoul, Korea, finds that G20 countries have largely continued resisting protectionist pressures and that the majority of new investment measures has aimed at facilitating and encouraging investment flows.⁴ At the Ministerial Roundtable, the point was made that tangible development benefits emanating from foreign investment can help overcome protectionist demands at the domestic level.

The challenge of investor-State dispute settlement

Both the Ministerial Roundtable and the IIA Conference gave special attention to the challenges arising from investor-state dispute settlement (ISDS), where the increasing number of cases and the expansive interpretations of provisions around investment protection have raised growing unease about the balance between governments' and investors' rights and obligations. Concerns were expressed regarding ISDS in its current form, notably its lack of predictability, legitimacy and transparency, as well as its incoherent jurisprudence and strong focus on litigation through international arbitration. At the Ministerial Roundtable, the ISDS regime was contrasted with the regime for settling trade disputes in the WTO. The fact that investors can bring international arbitration cases against sovereign states was considered to require prudence and thought on how to be dealt with.

At the IIA Conference, participants suggested that the predictability, consistency and stability of the ISDS system could be re-ascertained through the involvement of annulment committees or an appellate system. Approaches currently undertaken to improve the system include changes in procedural rules, consideration of less adversarial means of dispute settlement, and efforts towards dispute avoidance and prevention.⁵ In both meetings, there was a call to strengthen dispute avoidance and preventive mechanisms, and to more frequently consider the use of alternative dispute resolution techniques (e.g. conciliation and mediation) in the context of international investment disputes. National ministries also have to put adequate administrative procedures in place and coordinate among themselves to be sufficiently equipped for the management and prevention of investor-state disputes.

International cooperation

The contemporary challenges confronting the international investment regime call for enhanced international cooperation on investment. Moreover, today's most daunting public policy challenges—including food security, climate change, economic crisis and poverty—are global and can only be resolved jointly. With foreign investment playing a key role in overcoming them, international cooperation on investment issues appears ever more warranted.

International cooperation can take many forms, ranging from the sharing of experiences and best practices, to capacity building, cooperation and forms of inter-governmental consensus building towards a globally shared view on investment issues and more coherent body of international law.

At the WIF, ministers recognized the benefits of engaging multilaterally on investment issues with a view to harnessing investment for sustainable development and materializing concrete development outcomes. Together with its research and policy analysis, and dedicated technical assistance and capacity building activities, UNCTAD's consensus-building activities can contribute to making investment rules work for sustainable development, as demonstrated by the 2010 World Investment Forum. Follow-up actions will lead the way to UNCTAD's third WIF, which is scheduled in conjunction with the UNCTAD XIII Inter-governmental Conference, to be held in April 2012 in Doha, Qatar.

Author

James X. Zhan is Director, Investment and Enterprise Division (DIAE), UNCTAD. More information on the World Investment Forum 2010 is available from <http://www.unctad-worldinvestmentforum.org/>

For specific queries regarding the WIF or UNCTAD's work on investment and enterprise, including on international investment agreements (IIAs), please contact Elisabeth.Tuerk@unctad.org.

Notes

¹ UNCTAD's first WIF was held in conjunction with UNCTAD's quadrennial inter-governmental conference, UNCTAD XIII, in Accra, Ghana. <http://www.unctad.org/templates/Page.asp?intItemID=4992&lang=1>.

² See UNCTAD (2010). *World Investment Report 2010. Investing in a Low-carbon Economy* (New York and Geneva: United Nations), United Nations Publication, Sales No. E.10.II.D.2. Available at: http://www.unctad.org/en/docs/wir2010_en.pdf.

³ See UNCTAD's quarterly Investment Policy Monitors (IPMs), which provide up-to-date and country-specific information on national and international investment policies. For the latest version, see UNCTAD (2010). *Investment Policy Monitor, No. 3* (October 2010). Available at: http://www.unctad.org/en/docs/webdiaeia20105_en.pdf.

⁴ United Nations Conference on Trade and Development (UNCTAD) and Organisation for Economic Co-operation and Development (OECD) (2010). *Fourth Report on G20 Investment Measures* (4 November 2010). Available at: www.unctad.org/en/docs/wto_oecd_unctad2010d1_en.pdf.

⁵ UNCTAD (2010). *Investor-State Disputes: Prevention and Alternatives to Arbitration. Series on International Investment Policies for Development* (New York and Geneva: United Nations), United Nations publication, Sales No. E.10.II.D.11. Available at: http://www.unctad.org/en/docs/diaeia200911_en.pdf.

news in brief

European Union institutions consider the EU's future international investment policy

Debate on the future of the European Union's international investment policy is heating up as EU institutions weigh in with their recommendations.

With the entry into force of the Lisbon Treaty on 1 December 2009, the EU received exclusive competence over foreign direct investment, which has shifted the power to negotiate bilateral investment treaties with non-EU states (often termed 'extra-EU BITs') from the EU member states to the Union.

As a result, three European institutions—the European Commission, the European Council and the European Parliament—have begun the delicate task of forging a new legal framework for the negotiation of international investment agreements by the EU, as well as for a transition process for the more than 1,200 existing extra-EU BITs. The European Commission kick-started the discussion in a 7 July 2010 draft Regulation and Communication. The Regulation would give member states temporary authority to maintain their existing BITs with non-EU countries, and even negotiate new ones. However, the Commission would have broad powers to withdraw that authority if it concluded that a member state's BIT compromised the EU's investment policy.

On 9 November 2010 the European Parliament held a hearing in Brussels to discuss the Commission's proposal. An important contribution to the debate came from Dr. Stephan Woolcock of the London School of Economics and Political Science (LSE), who presented a study commissioned by the Parliament, and prepared by LSE and the Overseas Development Institute (ODI).¹

The study addresses both the future EU policy on foreign direct investment as well as the draft regulation on transitional arrangements, and proposes a menu of options with respect to both issues. One particular point of concern is the "extreme vagueness" of the provisions in the current BITs:

"A problem arises, however, from the extreme vagueness of the BIT provisions, the absence of any binding and consistent case law as well the lack of any central instance that could guarantee the uniform interpretation and application of the law. This means that member states may have to pay large damages awarded by arbitrators who owe no allegiance to any constitution or constitutional treaty other than the BIT itself."

With respect to the transitional arrangement, the study on the one hand appears to support the Commission's draft regulation as a "framework that has the merit of ensuring that the Union can effectively take up its new exclusive competence and consistently develop its future policy on international investments." At the same time, the study stresses the need for an institutional balance.

The European Council, which represents the interests of EU member states, has also weighed in with its views.² In a document published on 25th October, the Council emphasizes that the new EU investment policy should not affect the protections under current member state BITs, and that the pillars of future EU investment agreements should

be the provisions traditionally included in existing member states' BITs—such as fair and equitable treatment, full protection and security, protection against expropriation, and dispute settlement mechanisms.

The Council also stresses that existing member state BITs should remain in force so long as they are not replaced by new EU investment agreements.

In contrast, the rapporteur of the European Parliament's Committee on International Trade (INTA), Swedish Green MEP Carl Schlyter, has produced a draft report recommending a sunset clause for all extra-EU BITs.³ Under Schlyter's proposal, member states would be authorized to retain their BITs for a maximum of 13 years.

Schlyter warns that, "without a timeline, the [European Commission's draft] Regulation would allow the emergence of parallel, potentially incompatible investment regimes, thus adding to legal uncertainty. While a sufficiently long transition is needed, an open ended duality in the EU investment policy would contradict the effective implementation of Article 207 (1) of the TFEU which clearly states that investment policy is the competence of the Union."

A second INTA rapporteur, Kader Arif, comments on the Commission's Communication.⁴ Arif expresses concern that investment treaty arbitrations may lead to conflicts between private interests and public regulatory activities, and calls for "good quality" agreements that take into account social and environmental concerns.

Arif also argues that the dispute settlement regime should include "greater transparency on cases heard in court and the judgments themselves, the opportunity for parties to appeal, the obligation to exhaust local judicial remedies (under certain conditions) before initiating international arbitration, the opportunity to use amicus briefs and the obligation to select one single place of arbitration and thus avoid 'forum shopping.'"

While the European Commission has said it does not want to create a model EU investment treaty, Arif warns that this flexibility should not lead to "picking and choosing" among the elements he outlines in the Working Paper.

Transparency in UNCITRAL arbitration rules discussed in Vienna

A working group of the United Nations Commission on International Trade Law (UNCITRAL) turned its attention to the issue of transparency in investor-state arbitration, during a meeting in Vienna, Austria on 4-8 October 2010.

The UNCITRAL arbitration rules are the second most popular rules for arbitrating investor-state conflicts, behind the World Bank's International Centre for Settlement of Investment Disputes.

The question of whether investment-treaty arbitrations conducted under the UNCITRAL rules should be subject to greater transparency came under the spotlight several years ago as the Working Group II began deliberations on revising the rules. However, at a meeting in February 2008, the Working Group decided to proceed with revising the rules in their 'generic' form, before exploring the specific issue of transparency in investor-state arbitration.

Having adopted the revised generic UNCITRAL rules in June 2010, the meeting in October 2010 was the first to discuss how transparency should be dealt with in the UNCITRAL rules.

In this context, the issue of transparency includes a range of practices, including publicly registering cases (such as through an on-line docket), publishing documents related to the arbitration, and providing rules for third-party (*amicus curiae*) submissions.

The UNCITRAL secretariat reports that there was “general agreement” among the participating governments that transparency was desirable in investor-state arbitration, but views differed on how best to achieve this objective.

A major divergence involves whether the transparency rules applicable to investment arbitration should become the default rules in case an investment treaty refers to UNCITRAL Rules. For instance, an annex to the generic UNCITRAL rules could be drafted to apply to all investor-state arbitration, unless the parties to the investment treaty explicitly opted out of the annex. This would ensure the maximum application of the transparency rules while leaving the opt-out option for states if they so wish. But a few states appear to prefer leaving the default rules as the less transparent generic rules. A further point of contention is whether or not the new rules should apply to disputes initiated after their adoption based on treaties that came into effect before their entry into force.

Members of the Working Group also debated what types of information should be made public; for example, whether it would only include basic facts about the arbitration (i.e., names of the disputing parties and the subject matter of the dispute), or all documents submitted to, and by, arbitral tribunals in investor-state arbitrations.

As a next step, the UNCITRAL secretariat has been asked to prepare analysis on the form and substance of the transparency issues discussed at the meeting, including sample provisions on transparency.

Uruguay prepares defense against Philip Morris

The government of Uruguay is preparing for a controversial investment dispute with the tobacco company Philip Morris International (PMI), despite reports the government would water down the cigarette labeling requirements that sparked the conflict.

PMI alleges that the labeling requirements and recent tax increase harm its investments and infringe on its trademarks in violation of the Switzerland-Uruguay bilateral investment treaty. PMI has its international headquarters in Lausanne, Switzerland.

The law firm Foley Hoag announced in a press release in October 2010 that it has been hired to defend Uruguay.

Philip Morris also turned to Uruguay’s Supreme Court, pleading that the government’s anti-tobacco measures are unconstitutional. But that case was recently struck down. The court’s 20 November 2010 decision states it is “an essential duty of the state ... to adopt all measures it considers necessary to maintain the collective health” of citizens.

Uruguay has received broad international support for its efforts to discourage smoking: more than 170 countries signed a World Health Organization accord that expressed concern that the tobacco industry was seeking to undermine government policies to control tobacco consumption.

Congress to be consulted on revisions to the U.S. model BIT

The Obama administration will consult with the new U.S. Congress before finalizing a new model bilateral investment treaty.

Last year the United States began reviewing its model BIT with an emphasis on three topics: (a) dispute settlement provisions; (b) state-owned enterprises; and (c) financial services issues. The U.S. model BIT, which is carefully adhered to in U.S. negotiations over bilateral investment treaties and investment chapters in free trade agreements, was last updated in 2004.

As part of the review process, an advisory committee to the U.S. Department of State and the Office of the United States Trade Representative was established. Consisting of some 27 advisors, including participants from labour groups, business organizations, academia, public policy groups, and the legal profession, the committee offered their diverse views in September 2009.⁵

Indeed, the Obama administration had hoped to finalise a new model by the end of 2009.

“There is a continued discussion with Congress on what a model BIT would look like, and we don’t want to start negotiating internationally before we have support from the Congress on at least the broad framework for a model BIT,” said Under Secretary of State for Economic, Energy, and Agricultural Affairs, Robert Hormats, as reported by Inside US Trade.⁶

Inside US Trade reports that the question of whether to include obligations on labour rights and environmental protection is one of the obstacles to agreeing on a new model.

Notes

1 The EU Approach to International Investment Policy after the Lisbon Treaty, European Commission Directorate-General for External Policies, Policy Department, 2010, <http://www.europarl.europa.eu/activities/committees/studies.do?language=EN>

2 Conclusions on a comprehensive European international investment policy, European Council, 25 October 2010, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/117328.pdf

3 Carl Schlyter, Proposal for a regulation of the European Parliament and of the Council establishing transitional arrangements for bilateral investment agreements between Member States and third countries, 18 November 2010, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-452.807+01+DOC+PDF+V0//EN&language=EN>

4 Kader Arif, Working Document on the European Union’s future investment policy, 18 November 2010, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-452.839+01+DOC+PDF+V0//EN&language=EN>

5 Advisory Committee on International Economic Policy Submits Report on Review of U.S. Model Bilateral Investment Treaty, September 2009, <http://www.state.gov/r/pa/prs/ps/2009/sep/130097.htm>

6 “Hormats: Administration Consult With Congress On Model BIT”, Inside US Trade Vol. 28, No. 45, November 19, 2010

awards & decisions

Georgia loses dispute with Greek and Israeli oil investors *Ioannis Kardassopoulos and Ron Fuchs v. The Republic of Georgia (ICSID Case Nos. ARB/05/18 and ARB/07/15)* Martin D. Brauch

Two oil traders have been awarded more than US\$45 million each in damages from the Republic of Georgia in an ICSID award that advances a broad interpretation of the fair and equitable treatment (FET) standard.

The claimants, Ioannis Kardassopoulos and Ron Fuchs, are the co-owners of Tramex International, which in 1992 formed a joint venture (called GTI) with the state-owned Georgian Oil. A year later, GTI obtained a 30-year concession over Georgia's main oil pipeline. However, in 1996 Georgia terminated GTI's concession and turned over some of the rights previously held by GTI to a consortium of transnational oil companies.

A governmental commission established in 1996 considered compensating Kardassopoulos and Fuchs. But a new governmental commission established in 2004 finally concluded that the investors were not entitled to any compensation.

In response, Kardassopoulos, a Greek national, initiated arbitration against Georgia in August 2005, claiming that Georgia breached the expropriation and the FET provisions of the Georgia-Greece BIT and of the Energy Charter Treaty (ECT). A year and a half later, Fuchs, an Israeli national, initiated proceedings on the same facts, but only on FET grounds under the Georgia-Israel BIT.

The same arbitral tribunal adjudicated both cases jointly. The tribunal affirmed its jurisdiction over Kardassopoulos' expropriation claim under the ECT, as well as over both investors' FET claims under the two BITs.

Georgia argued that the investors should not be heard because the claim was untimely, having waited ten years to file their case. But the tribunal dismissed this argument on the grounds that the delay was not unreasonable or unjustified—the investors had sought compensation from 1996 until 2004 and were reasonably led to believe that they would receive compensation.

Georgia also raised three contractual defences to the Joint Venture Agreement between Tramex and Georgian Oil—unconscionability, misrepresentation and lack of performance. These arguments were also rejected, as the tribunal concluded that Georgia was not disadvantaged in the negotiations, that the investors did not misrepresent their experience and financial resources, and that they substantially performed the contract until Georgia deprived them of their rights.

In its 3 March 2010 award, the tribunal concluded that Kardassopoulos' investment was unlawfully expropriated in violation of the ECT, because Georgia neither provided "prompt, adequate and effective" compensation nor conducted the expropriation under due process of law. Endorsing *ADC v. Hungary*, the tribunal found that the investors did not have a "reasonable chance within a reasonable time" to be heard and claim their rights.

The tribunal then turned to Fuchs' fair and equitable treatment claim, interpreting the standard broadly as a violation of the investor's "reasonable expectations." Although the Georgia-Israel BIT only entered into force after the expropriatory acts, the tribunal considered that Georgia's assurances of compensation after the investment gave Fuchs legitimate expectations of a fair and equitable compensation process.

In light of the treaty's preamble, which sets out its object and purpose as promoting "conditions favorable for investors and investments," the tribunal interpreted the FET protection as far-reaching, both temporally and content-wise. It noted:

"[T]he fact that it was after the investment was made that specific assurances of compensation were given, which assurances gave rise to a specific expectation of compensation, does not preclude Mr. Fuchs from holding throughout the term of his investment the legitimate expectation that Georgia would conduct itself vis-à-vis his investment in a manner that was reasonably justifiable and did not manifestly violate basic requirements of consistency, transparency, even-handedness and non-discrimination."

On damages, the tribunal invoked the customary international law standard since there were no specific treaty provisions on the amount of compensation for unlawful expropriation. Counsel for Kardassopoulos argued that the unlawful character of the expropriation should result in damages greater than those owing in case of a lawful expropriation. Specifically, Kardassopoulos sought damages equal to the value of his rights prior to the expropriation, plus any lost profits, or the value of its rights at the date of the award, whichever was determined to be higher.

In contrast with a recent judgment of the European Court of Human Rights' Grand Chamber, the tribunal agreed with Kardassopoulos that damages should be calculated on the date of the arbitral award, rather than the earlier date of the expropriation. However, in the end, the tribunal considered that Kardassopoulos would likely have sold his shares in GTI in 1995, and for this reason determined that he should not be compensated for the value gained between the expropriation and the award date. Thus, it awarded Kardassopoulos damages of US\$15.1 million, based on the fair market value of his rights on 10 November 1995, a few months prior to the final act of expropriation, to ensure restitution of the market value the investment had before any expropriatory act.

The tribunal followed the same reasoning regarding compensation for the FET breach. It found that since the FET breach led to the same consequence as the unlawful expropriation—depriving the investors of their investment without compensation—there was no reason to differentiate between the damage caused to the two claimants; thus Fuchs was also awarded US\$15.1 million.

Finally, the tribunal applied pre-award interest (between 1996 and 2010), raising the sum owed by Georgia to each investor to some US\$45 million. In addition, Georgia was condemned to pay the investors about US\$8 million in arbitration costs.

Post-award developments can be expected in this case. On 16 July 2010 the ICSID Secretariat registered an application for annulment, and an annulment committee was constituted on 11 August 2010. Following a request by the claimants, on 18 November 2010 the annulment committee ordered Georgia to post a US\$100 million financial guarantee, as a condition for staying the award during the annulment process.

The dispute garnered headlines in October when Fuchs was arrested in Georgia. According to the Georgian media, Fuchs and a colleague are charged with attempting to bribe Georgia's deputy finance minister to dissuade the government from pursuing its annulment request.

The arrest of Fuchs and the decision to order the financial security were not connected, stressed the annulment committee.

Notes

Mr. L. Yves Fortier, C.C., O.Q., Q.C. (president), Professor Francisco Orrego Vicuña (appointed by Kardassopoulos) and Professor Vaughan Lowe (appointed by Georgia) formed the arbitral tribunal. Skadden, Arps, Slate, Meagher and Flom LLP (UK and US) represented Kardassopoulos and Fuchs. DLA Piper Gvinadze & Partners LLP (UK and US) represented Georgia. The award of 3 March 2010 in *Kardassopoulos v. Georgia* is available at <http://ita.law.uvic.ca/documents/KardassopoulosAward.pdf>

Tribunal dismisses claims against Hungary in ECT dispute over power stations *AES Summit Generation Limited and AES-Tiza Erőmű Kft. v. Republic of Hungary (ICSID Case No. ARB/07/22)*

Martin D. Brauch

An ICSID tribunal dismissed all claims by the British energy company AES against Hungary on the grounds that Hungary acted reasonably when it curbed the profits of public energy utilities.

The dispute is rooted in AES' US\$130 million investment in Tisza II and other Hungarian power stations in 1996, at a time when Hungary was privatizing parts of its energy sector.

A Power Purchase Agreement (PPA) between AES and Hungary established a pricing formula to be applied once Hungary ceased to administer energy generation prices.

However, in reaction to public outrage over the allegedly high profits of public utility companies, Hungary enacted price decrees in 2006 and 2007, restoring the administrative pricing regime.

The return of administered prices caused AES significant losses of revenue, prompting the company to seek compensation through ICSID arbitration under the Energy Charter Treaty (ECT), a multilateral trade and investment treaty governing the energy sector. AES argued that the PPA had created legitimate expectations that an administered pricing system would not be reintroduced.

In addition, the company maintained that Hungary breached its duties to respect its contractual obligations, to act in good faith and to provide stability and predictability. It also complained that the reintroduction of the decrees was arbitrary, non-transparent, lacking in due process and discriminatory.

AES based its claims on provisions of the ECT regarding fair and equitable treatment, unreasonable measures, constant protection and security, and expropriation, among others.

In its 23 September 2010 award, the tribunal concluded that it was within Hungary's rights to reintroduce a regulated pricing system. Importantly, the PPA did not contain a "stabilization clause" that would temporarily limit Hungary's sovereign right to change its law. Since Hungary did not provide any assurances, AES could have no legitimate expectations, the tribunal concluded.

Moreover, Hungary's acts were deemed a valid, reasonable and proportionate exercise of regulatory power, consistent with their rational public policy objectives. "Excessive profits," according to the tribunal, "may well give rise to legitimate reasons for governments to regulate."

AES also maintained that the constant protection and security standard also included the obligation to ensure legal protection and security. The tribunal rejected this claim, however, reasoning that the standard does not rise to the level of protecting the investor against state regulations based on rational public policy grounds, such as Hungary's price decrees.

Finally, AES argued that the decrees amounted to expropriation, entitling the company to compensation from the Hungarian government. In dismissing this claim, the tribunal asserted that not every state regulation with negative effects on a foreign investor amounts to an expropriation. The price decrees did not deprive AES of its ownership or control over its investment, nor did they cause a substantial devaluation of the investment—in fact, AES continued to make significant profits.

Rejecting all claims, the tribunal determined that each party bore its own costs and equally shared in the charges of the tribunal and the ICSID secretariat.

Notes

Mr. Claus von Wobeser (president), J. William Rowley QC (appointed by AES) and Professor Brigitte Stern (appointed by Hungary) formed the arbitral tribunal. Allen & Overy (London) and Polgár & Beb k Law Office (Budapest) represented AES. Arnold & Porter (Washington and Brussels) and Law Office of Dr. János Katona (Budapest) represented Hungary. The full arbitral award is available at <http://ita.law.uvic.ca/documents/AESvHungaryAward.pdf>

Ukrainian government on the hook for intervention in hotel investment *Alpha Projektholding GmbH v. Ukraine (ICSID Case No. ARB/07/16)*

Martin D. Brauch

An ICSID award dated 8 November 2010 ordered Ukraine to pay US\$5.25 million in damages to Austrian investor Alpha Projektholding in a dispute over a failed hotel renovation deal.

Beginning in 1994, Alpha concluded several joint-activity agreements (JAAs) with Hotel Dnipro, a Ukrainian State-owned enterprise in Kiev, for the reconstruction of the hotel building. Under the agreements, Alpha would take a bank loan to pay Pakova—the company that would undertake the renovation—and would receive minimum monthly payments from Dnipro.

However, Dnipro's deteriorating finances led it to renegotiate one of the JAAs in 2000, suspending the minimum monthly payment until 2006 and prolonging the term of the agreement.

Ultimately, the hotel's dire financial straits led the Ukrainian government to transfer the authority to manage Dnipro from the State Tourist Administration to the State Administration of Affairs (SAA), which requested an official audit of Dnipro's financial activities. The audit indicated that Alpha's investment in Dnipro and its implementation were unlawful under Ukrainian law, due to misappropriations of funds and noncompliance with accounting standards.

Although Dnipro's new management reassured Alpha that the JAAs remained valid, Alpha no longer received payments under any of the JAAs as of July 2004.

After consultations between the Austrian and Ukrainian governments broke down, Alpha initiated ICSID arbitration against the Ukraine under the Austria-Ukraine Bilateral Investment Treaty (BIT) in 2007. Alpha claimed that the cessation of payments and other acts by Dnipro and the Ukrainian government amounted to breaches of several BIT provisions, including those on expropriation, fair and equitable treatment, and the umbrella clause.

Specifically, the tribunal found that Ukraine had ordered Dnipro to stop payments to Alpha and was responsible for Dnipro's continued failure to fulfill its contractual obligations.

With respect to the expropriation claim, the tribunal considered that neither Ukraine nor Dnipro indicated an intention to resume payments after they were terminated in 2004 or to pay Alpha its share in the JAAs. In light of the evidence, the tribunal concluded that Ukraine expropriated Alpha's rights under the agreements, by substantially and permanently depriving the investment of economic value.

Although the tribunal agreed with the Ukraine that Alpha did not precisely articulate what legitimate expectations were undermined by the Ukraine, it found that Alpha had a legitimate expectation that the Ukraine would not interfere with the JAAs. According to the tribunal, the Ukraine and the SAA frustrated this expectation by effectively negating the JAAs, thus breaching the fair and equitable treatment standard under the BIT.

However, the tribunal dismissed Alpha's umbrella-clause claim—which would have elevated a breach of contract to a breach of the BIT—on the grounds that Alpha did not enter into any contracts with the Ukraine, but only with Dnipro, which was not acting in a governmental capacity.

One noteworthy aspect of the award is the tribunal's treatment of the definition of "investment" under the ICSID Convention. Finding that Alpha had made an "investment" within the meaning of the BIT, the tribunal noted that the ICSID Convention does not define the term. To determine whether Alpha had an "ICSID investment," the arbitrators considered *Salini v. Morocco* (2004), an often-used starting point in ICSID jurisprudence for determining the existence of an "investment."

In this case, the tribunal expressed unease with the Salini test, in large part because it purports to evaluate the contribution of an investment to the host country's economic development. According to the tribunal, such criterion has little independent

content and allows a tribunal to improperly second-guess the investor's business, economic, financial or policy assessment in making an investment. The arbitrators argued that, in most cases, when an investment is found to exist under the BIT, it also meets the definition of "investment" under the ICSID Convention:

[W]hen the State party to a BIT agrees to protect certain kinds of economic activity, and when the BIT provides that disputes between investors and States relating to such activity may be resolved through ICSID arbitration, it is appropriate to interpret the BIT as reflecting the State's understanding that the activity constitutes an "investment" within the meaning of the ICSID Convention as well. [...] A tribunal would have to have very strong reasons to hold that the States' mutually agreed definition of investment should be set aside (para. 315).

Having decided that Alpha had made an "ICSID investment" by implication of the definition of "investment" under the BIT, the tribunal nonetheless applied the Salini test, and concluded that Alpha satisfied its four criteria—sufficient duration, assumption of risk, financial contribution or commitment, and contribution to Ukraine's development.

Notes

Hon. Davis R. Robinson (chairman), Dr. Yoram Turbowicz (appointed by Alpha Projektholding), and Dr. Stanimir A. Alexandrov (appointed by Ukraine) formed the arbitral tribunal. Specht Rechtsanwalt GmbH (Vienna, Austria) and Sullivan & Worcester LLP (Boston, USA) represented Alpha Projektholding. The Ukrainian Ministry of Justice, Grischenko & Partners (Kiev, Ukraine), and Proxen & Partners (Kiev, Ukraine) represented Ukraine. The award of 8 November 2010 in *Alpha Projektholding v. Ukraine* is available at: <http://ita.law.uvic.ca/documents/Alphav.UkraineAward.pdf>.

EU investment treaties examined in health insurance dispute *Eureko B.V. v. The Slovak Republic (PCA Case No. 2008-13)* Martin D. Brauch

An arbitral tribunal has affirmed jurisdiction over a US\$100 million dispute between the Dutch company Eureko B.V. and Slovakia. The jurisdictional award of 26 October 2010 deals mainly with the relationship between European Union (EU) law and BITs between EU member states.

In response to the deficit accumulated by its universal public health insurance system, Slovakia liberalized the system in 2004. Based on those reforms, Eureko invested in Slovakia in 2006, offering health insurance through a subsidiary. However, the Social Democratic government elected in 2006 amended the 2004 reforms in a way that, according to Eureko, systematically reversed the liberalization carried out in 2004.

Arguing that the new policies did not comply with EU law, on 28 February 2008 Eureko filed a complaint with the European Commission. Later, based on that complaint, the Commission initiated infringement proceedings against Slovakia, which remain ongoing.

Eureko also initiated UNCITRAL arbitration against Slovakia on 1 October 2008. The company maintained that, by reversing the liberalization policies of 2004, Slovakia breached the provisions of the Dutch-Slovak BIT on expropriation, fair and equitable treatment, discrimination, full protection and security, and free transfer of profits and dividends. Both the Dutch government and the European Commission (EC) submitted written observations, as per the tribunal's invitation.

In particular, the Commission characterized intra-EU BITs (BITs between EU member states) as "anomalies within the EU internal market" which would eventually need to be terminated. It stated that the tribunal, being bound to apply EU law, should recognize the principle of supremacy of EU law and refuse to apply any incompatible BIT provisions, including the arbitration clause. Finally, it suggested that the tribunal suspended the arbitration pending the infringement proceedings.

According to Slovakia, as a matter of international law, EU law, Slovak law, and German law (applicable to the dispute as the law of the seat of the arbitration), the country's accession to the EC Treaty on 1 May 2004 effectively terminated the Dutch-

Slovak BIT or rendered its arbitration clause inapplicable, leaving the arbitral tribunal without jurisdiction over the dispute.

In support of its first argument, Slovakia posited that the Dutch-Slovak BIT was terminated by way of Article 59 of the Vienna Convention on the Law of Treaties (VCLT), which concerns the termination of treaties that deal with the same subject matter.

The tribunal rejected this argument for three reasons. First, the termination of treaties under the VCLT generally has to be invoked, which did not happen in the case of the BIT in question. Second, the EC Treaty cannot be considered as a successive treaty dealing with the same subject matter of the BIT. The tribunal found neither an intention that the EC Treaty terminated the BIT, nor an incompatibility that prevented concurrent application of both treaties. Third, the investor's right to bring the host State before an international arbitral tribunal (under the BIT) could not be equated with the right to bring a law suit against it before its domestic judiciary (under EU law).

The arbitrators also denied Slovakia's contention that the BIT provisions regarding fair and equitable treatment, expropriation, and full protection and security were covered by the EU law provisions on freedom of establishment and the prohibition on discrimination. Conversely, the tribunal held that there are rights under the BIT that are neither covered by nor incompatible with EU law. It also stated that the wider protections given by the BIT, although arguably in violation of EU law prohibitions on discrimination among EU Member States, were not a reason to deny Eureko's rights under the BIT.

In its second argument, Slovakia maintained that, pursuant to VCLT Article 30, the arbitration clause in the BIT was not applicable, as the EC Treaty was a successive treaty with provisions that are incompatible with that clause. The tribunal, however, saw no incompatibility. Particularly, it established that EU law did not prohibit investor-state arbitration, and that Slovakia could observe its BIT obligations without violating EU law.

Slovakia's third argument was that, under EU law considered as part of Slovak law, the arbitration clause in the BIT was invalid because it was incompatible with the EC Treaty, and with the principles of autonomy and supremacy of EU law. Slovakia further maintained that the BIT was superseded by EU law, which had direct effect, prevailed over both national law and international treaties, and could only be interpreted by the European Court of Justice (ECJ). The tribunal did not accept this argument, concluding that it was bound to apply EU law, as part of the applicable law—effectively rejecting the claim that the ECJ has "interpretative monopoly" over EU law.

The final argument by Slovakia was that the dispute was not arbitrable under German law because it was outside the jurisdiction of the tribunal by virtue of EU law, which in turn is part of German law. However, having found that EU law did not deprive the tribunal of jurisdiction, the arbitrators dismissed this final contention.

Therefore, rejecting each of Slovakia's four arguments, the tribunal dismissed the country's jurisdictional objection. It also decided, for the time being, not to suspend the arbitration while the infringement proceedings are pending.

Further developments are expected as the tribunal proceeds to the merits of this case. While the tribunal acknowledged that it could be called to apply EU legal doctrines, it stressed that it has jurisdiction to rule upon breaches of the BIT, but not of EU law.

Notes

Professor Vaughan Lowe QC (president), Professor Albert Jan van den Berg (appointed by Eureko), and Mr. V.V. Veeder QC (appointed by Slovakia) form the arbitral tribunal. De Brauw Blackstone Westbroek N.V. (Amsterdam) represents Eureko. The Slovak Ministry of Finance, Rowan Legal s.r.o. (Bratislava), KSD Štovík advokátska kancelária, s.r.o. (Bratislava), and Baker Botts LLP (Washington, DC) represent Slovakia. The award on jurisdiction, arbitrability and suspension of 26 October 2010 in *Eureko v. Slovakia* is available at: <http://ita.law.uvic.ca/documents/EurekovSlovakRepublicAwardonJurisdiction.pdf>.

publications and events

The EU Approach to International Investment Policy after the Lisbon Treaty

European Commission Directorate-General for External Policies, Policy Department, 2010

This report provides analysis on the challenges and options with respect to the EU's approach to international investment policy post-Lisbon Treaty. The report argues that the Lisbon treaty's extension of EU exclusive competence to cover foreign direct investment (FDI) should enable the EU to conclude comprehensive trade and investment agreements, where in the past its coverage of investment has been only very partial. This should in turn strengthen the EU's ability to shape international investment policy. The greater negotiating leverage gained from negotiating comprehensive trade and investment agreements should also enable the EU to gain improved market access for EU investors in key target markets. Increased EU competence also means the EU will be able to establish uniform provisions for investors throughout the EU, in contrast to the current position in which investors in some member states have better protection in some markets than others. Available at: <http://www.europarl.europa.eu/activities/committees/studies.do?language=EN>

IISD Presentation at the European Parliament Hearing on Foreign Direct Investment

Nathalie Bernasconi-Osterwalder, IISD, November 2010

In this presentation to the European Parliament's Committee on International Trade in Brussels on 9 November 2010, Nathalie Bernasconi-Osterwalder surveys trends in the area of investment protection and dispute settlement, and discusses the investment treaty arbitrations facing Europe. Bernasconi-Osterwalder, who manages the IISD Investment Programme, identifies some of the main challenges that have become apparent in the area of investment protection and examines issues that have arisen in relation to the substantive rules contained in investment treaties and investor-state dispute settlement mechanism. Drawing on the experience of countries like the U.S. and Canada, she outlines ways in which some of the main problems could be addressed in the European context. Available at: <http://www.iisd.org/publications/pub.aspx?pno=1365>

Sustainable Development in World Investment Law

Edited by Markus W. Gehring, Marie-Claire Cordonier Segger, and Andrew Newcombe, Kluwer Law International, November 2010

This book features contributions from a variety of experts on recent developments in investment law negotiations and jurisprudence from a sustainable development law perspective. It offers answers to pertinent questions concerning advancements in investment law, including the negotiation of numerous regional and bilateral agreements as well as the increasing number of disputes resolved in the World Bank's International Centre for the Settlement of Investment Disputes (ICSID), from different developed and developing country perspectives. It lays out future directions for new treaty negotiations and dispute settlement proceedings. It also focuses on key issues in investment laws which have emerged as priorities in the negotiation of bilateral

and regional investment agreements, and have been clarified through recent decisions of the ICSID and other arbitral panel awards.

The Yearbook on International Investment Law & Policy 2009-2010

Karl Sauvant, Oxford University Press, October 2010

The Yearbook on International Investment Law & Policy 2009-2010 monitors current developments in international investment law and policy, focusing on trends in FDI, international investment agreements, and investment disputes. The book also looks at central issues in the contemporary discussions on international investment law and policy. Featuring contributions by leading experts in the field, it is intended to provide timely, authoritative information on FDI that can be used by a wide audience, including practitioners, academics, researchers, and policy makers.

Investment Incentives and the Global Competition for Capital

Kenneth P. Thomas, Palgrave Macmillan, November 2010

The battle of national, state, and local governments to attract investment has been a high priority for decades. For example, U.S. state and local governments give almost US\$50 billion in location incentives and over US\$70 billion in total subsidies annually. Developing countries often pay even more for investments despite the fact they are less able to afford to do so. Using case studies from around the world, and at all levels of government, Thomas shows that investment incentives are rarely a good policy, especially for countries lacking education and infrastructure. Finally, he analyzes the myriad methods of controlling incentives with an emphasis on the EU's comprehensive and largely successful state aid rules, illustrated by an extended case study of Ireland.

Events

2011

February

2-4

UNCTAD MULTI-YEAR EXPERT MEETING ON INVESTMENT FOR DEVELOPMENT (THIRD SESSION), Geneva, Switzerland

16-18

UNCTAD SINGLE-YEAR EXPERT MEETING ON THE CONTRIBUTION OF FOREIGN DIRECT INVESTMENT TO THE TRANSFER AND DIFFUSION OF TECHNOLOGY AND KNOW-HOW FOR SUSTAINABLE DEVELOPMENT IN DEVELOPING COUNTRIES, ESPECIALLY LEAST DEVELOPED COUNTRIES, Geneva, Switzerland

March

3

APRAG-ICSID CONFERENCE "ASIA AND INVESTMENT ARBITRATION", Seoul, Korea, <http://icsid.worldbank.org/ICSID/Index.jsp>

April

5

FIFTH ANNUAL INVESTMENT TREATY ARBITRATION CONFERENCE, Renaissance Mayflower Hotel, Washington, D.C.

May

6

ITF PUBLIC CONFERENCE: IS THERE AN EVOLVING CUSTOMARY INTERNATIONAL LAW ON INVESTMENT?

London, United Kingdom, <http://www.biicl.org/events/view/-/id/561/>

June

9-10

CONFERENCE ON TEN YEARS OF ENERGY CHARTER TREATY ARBITRATION ORGANIZED BY SCC, ICSID AND THE ENERGY CHARTER SECRETARIAT, Stockholm, <http://www.chamber.se/?id=33813>



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International Institute for Sustainable Development
International Environment House 2
9, Chemin de Balaxert,
5th Floor, 1219, Chatelaine,
Geneva, Switzerland

Tel: +41 22 917-8748
Fax: +41 22 917-8054
Email: itn@iisd.org