

**1<sup>st</sup> Annual Forum of Developing Country Negotiators  
October 1-2, 2007, Singapore**

**Meeting Report<sup>1</sup>**

The International Institute for Sustainable Development (IISD) in partnership with the Centre on Asia and Globalisation (CAG), Lee Kuan Yew School of Public Policy, National University of Singapore, organized the 1<sup>st</sup> Annual Forum of Developing Country Negotiators in Singapore October 1-2, 2007. The Forum was attended by over 30 negotiators representing more than 25 countries, as well as by a number of presenters drawn from private practice, research institutes and government.

Kishore Mahbubani, Dean of the Lee Kuan Yew School of Public Policy and Ann Florini, Director of the Centre on Asia and Globalization, opened the Forum. Dr. Florini explained that the event was of particular interest to the CAG because international investment law and policy is an integral part of the broader range of issues surrounding global governance. Dr. Mahbubani noted that the Lee Kuan Yew School of Public Policy is one of the world's fastest growing public policy schools in the world, with the number of faculty, students and programs all expanding rapidly. He said that forums like this were an important contribution to the qualitative growth of the school.

For its part, IISD has a long history of work in the area of investment, founded on the belief that sustainable development is essentially an investment problem. It is not possible to achieve the condition of sustainable development without new investment to replace unsustainable transport facilities, energy sources, industrial practices, etc. Yet the Institute has been struck by the fact that the international regime governing investment has been directed primarily at economic drivers, without addressing sustainable development.

One of purposes of the Forum was to strengthen the capacity of developing country officials who negotiate international investment agreements (IIAs). If done well, negotiating IIAs is a difficult task. The model agreements adopted by governments like the United States and Canada have grown much more complex in recent years, and the jurisprudence in investor-state arbitration is often opaque and uneven. Developing countries are at a stark disadvantage when negotiating with wealthier countries that have greater resources to throw into negotiations.

The second purpose was to create an opportunity for developing country negotiators to network, and share approaches and experiences. It is important to note that while developed countries have institutions like the OECD to develop common strategies on

---

<sup>1</sup> This report was produced by the IISD under its own responsibility.

international investment, no equivalent exists for developing countries. As such, the Forum provided the opportunity to do some strategic thinking about how developing country negotiators might best address their common challenge: finding the appropriate balance between the need to attract more foreign direct investment and the need to serve a wide range of public policy objectives, including economic development.

The Forum was led by participants, in order to promote the interests of developing countries. The role of the IISD and the CAG was to facilitate the process.

The structure of the report that follows is based on the substantive sessions around which the Forum was organized.

## **1. The impact of investment agreements on FDI**

*Do international investment agreements attract FDI? Conversely, does a lack of strong IIAs deter investment?*

There are a number of recognized benefits of foreign direct investment (FDI). An inflow of external savings into a country is generally good for the economy; it is not debt creating, and can provide valuable access to resources and know-how. Moreover, the benefits of FDI can reach beyond the specific sector where the investment occurs, enriching the broader economy.

Given the potential benefits of FDI, one of the rationales behind entering into bilateral investment treaties (BITs) is the promotion of foreign investment. Yet, despite some 10 years of research on the question, there is no conclusive answer on whether BITs improve FDI flows. When other factors that can promote FDI are controlled for, such as good governance and solid infrastructure, it is not clear whether BITs have had a significant impact.

There are several reasons for the lack of certainty on the relationship between BITs and FDI. These include data constraints (different researchers have used different data sets) and the selection of proxies (different models use different indicators to represent the various factors that impact on FDI) and design questions (different models use different time periods, countries, etc).

Nonetheless, the literature on this question does lead to some tentative conclusions. One is that BITs do have a positive effect on FDI flows. However, an important caveat is that this impact is not independent of domestic institutions and regulations. BITs don't substitute for institutional development, and in some cases might erode domestic institutions (for example, facilities for investor-state arbitration can relieve pressure to strengthen the domestic legal system). The literature also suggests a diminishing return when signing BITs: after signing a certain number of BITs, signing one more does not increase FDI by dramatically. Related to this, there may be a signaling effect whereby signing one BIT signals, even to non-Parties, that the countries involved are good hosts for investment.

While BITs might foster FDI, perhaps a more important question is whether that investment promotes development. Here the literature is inconclusive. As such, a number of participants underscored the need to work on improving domestic

institutions to ensure that investment treaties are not in conflict with national policy goals. At the very least, governments need to strive to ensure that the IIAs they sign do no harm. On the matter of further research into the impact of BITs on FDI, the view was shared that there is a need for country-specific work. A one-size-fits-all approach does not help negotiators who need to understand the needs and capacity of their particular country.

## **2. The meaning and nature of commitments on fair and equitable treatment: How can they be made fair and equitable?**

*What is the evolving legal interpretation of in the arbitration decisions of the commitment to fair and equitable treatment? How are negotiators reacting to those decisions? Is a clear standard in this area emerging?*

The provision of fair and equitable treatment (FET) is common to most BITs. Yet the vague meaning of this provision has led to differing interpretations by investment tribunals, which in turn has led to confusion for governments and investors alike.

Given this uncertainty, the drafters of the North America Free Trade Agreement (NAFTA) added an interpretative note which stipulates that the FET standard is equal to the customary treatment standard under international law. This clarification does not exist in most treaties, however, and its scope under NAFTA remains unclear given the evolving nature of customary international law in this field. Some non-NAFTA tribunals have found FET to be a stand-alone standard, with the words “fair and equitable” to be given their ordinary meaning. These tribunals have held that the test is the wording of the treaty, in particular whether or not the FET provision makes reference to international law. If it does not, certain tribunals have held that standard should be interpreted according to the ordinary meaning of “fair” and “equitable”. Notwithstanding this, several tribunals have held that the minimum standard has now evolved so that its content is substantially similar whether the terms are interpreted in their ordinary meaning or in accordance with customary international law.

A number of participants commented that tribunals have taken a one-sided approach when interpreting the FET standard, by focusing solely on the treatment granted to investors. It was argued that when interpreting the FET standard, it is important that tribunals also take into account other competing interests, such as those of communities and the environment. FET should be seen, in this regard, as a requiring fairness for all stakeholders, including local communities and governments, not just investors. Its application must also reflect the social and development context of the country where the investment has been made. A speaker commented that simply referencing the customary treatment standard under customary international law is not enough to ensure that tribunals will take into account this wider context when interpreting FET.

It was noted that a number of recent cases have not found governments liable for expropriation, but have found them in breach of the FET standard. While this is not a trend yet, it is worth paying attention to. If left unchecked, FET could potentially develop into a safety net standard behind expropriation. Participants agreed this would not be a welcome development. FET should be a standalone standard.

The differing interpretations that tribunals have given to FET led a number of participants to underscore the importance of carefully selecting members of the tribunal. Parties should pay special attention to how arbitrators have ruled in previous awards, in an effort to determine if they are likely to be sympathetic to the party's position in a given arbitration. For governments it is also vital to select arbitrators who understand the culture and political context of their country.

A number of participants stressed that countries need to decide what their priorities are when entering into an IIA, and then adjust the language of their treaties accordingly. One speaker commented that governments must be prepared to put the negotiations on hold if the risk of entering into an IIA is determined to be high. Others agreed that this is an important point: negotiators have to be prepared to tell their political masters when they think an agreement is not in the best interest of the country. It was stressed that a solid relationship between negotiators and their political masters is necessary if such advice is to be heeded.

### **3. Indirect expropriation, regulation and “police powers” exceptions: Is there a safety zone for governments?**

*To what extent can it be argued that a police powers exception exists in international law to shield normal regulatory measures from claims of expropriation? How has this question been handled in deliberations on indirect expropriation in investor-state arbitration? How have negotiators responded to the developments in this area?*

The regulation of investments is a common responsibility of government. However, regulatory actions that harm investments have formed the basis of claims under IIAs. The question, therefore, is how to strike the proper balance between the right and duty of governments to regulate on the one hand, and the need to provide protection to investors on the other.

There is no perfect definition of what constitutes *bona fide* regulatory measures. However, it is possible to provide a list of general categories of legitimate regulatory measures, such as the protection of human health, the environment, conservation, employee health and safety, human rights, the prevention of anti-competitive practices, and the promotion of consumer knowledge. The common thread running through each of these categories is the protection of the public from nefarious impacts of economic activity.

There are also activities which would not be included under the banner of *bona fide* regulatory actions. These include transferring privately held land to the state for a public purpose; transferring economic activity between actors doing the same thing in the same manner; or measures that are otherwise an abuse of government regulation-making powers.

The legal problem results from the uncertainty that has arisen out of recent cases where regulatory expropriation has been one of the key issues, leading to a lack of clarity and certainty for governments. The prospect of a tribunal finding that indirect expropriation has occurred as a result of regulatory action can lead governments to curb efforts to regulate in the public interest, a phenomenon termed regulatory chill.

There are some responses that governments can make to safeguard the right to regulate in the public interest. Negotiators can reinforce the police powers rule within the text of IIAs, and place limits on the scope of expropriation, both through new language in the expropriation provisions in IIAs as well as in preambular texts, and the use of other forms of exceptions. These are set out in detail in the conference background papers.

It was observed that the investment chapter of the post-NAFTA US and Canadian investment agreements states that only in “rare” circumstances will normal government regulatory acts be regarded as indirect expropriation. (The US and Canadian post-2000 IIAs seem to be the only ones with this language.) One speaker warned that the use of the caveat “rare” leaves the backdoor open for claims tied to regulatory action. There was some debate over the extent to which investment tribunals have recognized a state’s right to regulate. One participant said that the regulatory right and duty of governments has been safely guarded under the post-NAFTA construction in US and Canadian agreements. However, other participants challenged whether there is such clarity. One participant said that tribunals have shown greater restraint with respect to regulatory expropriation than with the interpretation of FET, in part due to an understanding of the serious repercussions of considering all regulatory acts as expropriations.

A participant raised the possibility of building an inter-governmental review mechanism into IIAs, which would allow states to assess an investor’s claim if it related to regulatory expropriation, before the claim could proceed to investor-state arbitration. It was noted that a similar inter-governmental review mechanism exists under NAFTA and other agreements for claims relating to taxation. However, a number of participants voiced skepticism over whether this would work in practice. It was said that one of the purposes of investment treaties is to remove the home government of the foreign investor from the dispute, and allow the investor-state dispute settlement mechanism to take place. As such, the home government of the investor would likely avoid getting involved in the state-state review.

#### **4. Expanding the reach of arbitration: choice of forum, umbrella clauses and more**

*What have recent rulings held on the choice of forum clause, and on the so-called “umbrella clause”? What are the implications of these provisions in terms of expanding the coverage of international law?*

This session began by drawing the distinction between claims that arise out of a contract and claims that arise out of a treaty. There is a key difference in the law that governs these two categories of investor-state disputes: contract claims are governed by national law while treaty claims are governed by international law.

Questions arise, however, when contract and treaty claims meet: what happens when an investor has a contractual agreement, which mandates that disputes be settled in domestic courts, but is also protected under a BIT that allows for international arbitration? Tribunals have found that a state can be in breach a treaty, and not a contract, and vice versa. This is because a treaty claim is measured under international law, while contracts are governed under national law.

States have raised concern that disputes which relate to a contract have been “dressed up” as treaty claims in order to bypass domestic courts. Several participants voiced the opinion that it was poor public policy to settle contractual claims by substituting the choice of fora clauses in these agreements with an international arbitration option contained in a BIT. BITs are not meant to provide a broad substitute for a dispute resolution forum agreed to by parties in a contract.

A speaker discussed how investors have used broad dispute resolution clauses generally drafted to cover ‘all’ or ‘any’ disputes arising out of an investment together with ‘umbrella clauses’ (i.e. an undertaking by states to observe all obligations with respect to an investment), to bring their contract claims before an investment treaty tribunal. In cases where treaties contain an umbrella clause, the decisions of investment treaty tribunals go in broadly two different ways- one school of thought has interpreted an umbrella clause as meaning that all claims arising out of a breach of contract are elevated to the level of a treaty claim, while the other set of decisions believes that an ‘umbrella clause’ does not have this impact.

A similar scenario exists with respect to generally drafted dispute resolution clauses- with one group of decisions holding that broad dispute resolution clauses cover contract claims and even those based upon breach of domestic law, while others believe that the language was not intended to have such a broad reach. The fact that such provisions are drafted so broadly and generally in BITs allows tribunals a wide discretion to interpret their impact. Notably, some capital exporting states like the United States are explicitly providing the ability to bring contract claims in dispute resolution clauses in their BITs, without leaving it to the vague umbrella clause provision.

A speaker underscored the point that states need to step back and determine what claims they want to settle through international arbitration. A number of participants echoed this point: governments must be very clear about their intentions when drafting treaties. If they do not want contractual disputes to go to international arbitration, then they need to draft treaties keeping in mind that the implications a broad dispute resolution and/or an umbrella clause can have.

## **5. Elements of investment liberalization**

*What are the implications of some of the key elements of investment liberalization being proposed in modern international investment agreements?*

The discussion moved from the legal aspects of IIAs that provide investor protection, to the commitments which open up markets to foreign investors. Investment liberalization is very much a political decision. Under customary international law there is no legal obligation to allow foreign investors into your country.

The World Trade Organization’s General Agreement on Trade in Services (GATS) was the first major multinational instrument to set legal rules on investment liberalization in the services sector. In what would have been a significant advancement to the GATS, the OECD’s Multilateral Agreement on Investment (MAI) included liberalization commitments in the services and non-services sector. But the MAI crumbled in the face of broad opposition from governments and civil society,

and resistance to investment liberalization in a number of OECD countries was part of the reason for that failure.

Efforts to bring broad investment liberalization commitments into the WTO negotiations have also been blocked, in this case due to entrenched opposition from developing countries. Participants noted that one reason developing countries have resisted including investment in the WTO was that they didn't want to negotiate tradeoffs between market access for goods and investment liberalization. Some negotiators said that in bilateral and regional trade agreements, they had been pressured to make concessions on investment liberalization in exchange for market access in areas like agriculture. It was noted that such tradeoffs make little sense from the perspective of development policy. Rather, they are a function of the give and take of the negotiating room.

There are two basic forms of investment liberalization: the top down (or negative list) approach and the bottom up (or positive list) approach. Under the top down approach there is a general obligation to liberalize, with a list of excluded sectors. Under the bottom up approach, governments list those sectors which will be opened up. Both approaches require additional annexes for exceptions for specific discriminatory measures that will be preserved even for sectors that have been liberalized under the agreements. This makes the negotiation and implementation of investment liberalization provisions very complex, yet critical, for the states involved.

Participants spent time discussing the risks and benefits of each approach. Some expressed the view that a bottom up approach was safer: if a country makes a mistake, better to leave out a sector under the bottom up approach than neglect to exclude a sector it does not want liberalized using the top down approach. However, some participants stressed the merits of the top down approach. It was said that this approach forces governments to go through the exercise of thoroughly analyzing their country's economic sectors and the domestic regulations that govern investments. It is a large job, but once the work is done the country is in a better position for future negotiations.

It was stressed that negotiators need to pay careful attention to performance requirements if they are liberalizing foreign investment. These would include national laws that direct certain functions of an investment, such as levels of local investment and restrictions on the use of inputs. Performance requirements are often banned in IIAs that include extensive liberalization commitments. Yet it is important for governments to know that they can carve out the policy space to retain performance requirements. To keep that option open, governments need to explicitly preserve legal measures that allow imposition of performance requirements, or they could be in breach of obligations in areas such as National Treatment and Most Favoured Nation Treatment.

## **6. Strategic defenses to arbitration**

*What sorts of provisions are there in current international investment agreements that would allow states an appropriate defence? What non-treaty-based defences might be available?*

This session began with some statistics on the outcomes of treaty-based arbitration. It is currently impossible to have definitive numbers, as some arbitral decisions are not made public. But based on the anecdotal knowledge of one of the speakers, it was said that over half (58%) of all arbitrations have not awarded damages to investors. In awards that do provide damages, the amount varies widely. A number of participants shared the view that the cost of these awards, even those on the lower end of the scale, can present a heavy burden on public coffers. The expense of defending a claim is also high for developing countries.

It was explained that one of the first questions for governments that face a claim by a foreign investor is whether to object on jurisdictional grounds. The risk is that this stage of the arbitration can go on for some years, and be expensive. It is also rare that governments are successful. Nonetheless, governments almost always contest jurisdiction. There is a strategic advantage to arguing jurisdiction in that the state makes their submission to the tribunal first, providing the opportunity to explain the government's side of the story before the claimant.

In arguing against jurisdiction, there are a number of factors that states should take into account. First, some basic elements must be present: there needs to be an investor, an investment, a dispute and an arbitration agreement. States can then measure a number of questions against the treaty used to launch the dispute. It is important to ask whether they can challenge the nationality of the person or the business. States must also question whether there is an investment as defined under the treaty. For example, certain tribunals have found that investments which have not had a significant economic impact are not covered. The scope of the treaty with respect to time can also provide a potential defence. Are disputes that existed before the treaty came into force covered, for instance?

If the proceedings move on to a deliberation of the merits of a claim, a new set of potential defences come into play. One is the conduct of the investor: has there been a lack of due diligence by the investor? In other words, what should the investor have known or done as a prudent businessperson? This is a potentially good defense against claims based on breaches of the FET standard.

It might also be asked, though panels have differed on its relevance: "Has the investor misrepresented itself? Have they been in compliance with domestic law?" This is not an easy defence however, as it requires arbitrators to sit as judges of domestic law. The defence of economic necessity might also be relevant. This has been used by Argentina where a severe economic crisis moved the government to renege on commitments made to foreign investors, sparking dozens of lawsuits under BITs. This defense has seen mixed results, with some tribunals rejecting it and others accepting it, but generally on a time-limited basis.

At the close of this session, the discussion returned to the problem of inconsistent jurisprudence in treaty-based arbitration. It was stressed that governments face far more uncertainty in investment arbitration than in trade disputes, which are settled under the rubric of the WTO. The idea of an appellate body, such as exists under the WTO dispute resolution system, was raised. A speaker noted that while the WTO system is not perfect, it has helped to stabilize jurisprudence and strengthen the

credibility of the trade law system. However, it was also observed that there seems to be little political will to create an appellate body to oversee investment arbitration. The World Bank's International Centre for the Settlement of Investment Disputes (ICSID) – a popular venue for arbitrating investment disputes - had recently suggested this idea to member governments, but it was not endorsed. The comment was made that justice may be better served if there is an appellate body, but the downside is time and cost, in a mechanism that is widely touted for its (relative) speed and efficacy. It was queried whether this would in fact add more time or costs, as it could replace other ad-hoc mechanisms now used to review arbitral decisions. At the moment, governments seem to think it is not worth it.

## **7. Panel Roundtable: Towards a strategic agenda**

*Are there elements of a “Southern Agenda” on investment? What might they be? What sorts of institutions are required to pursue that agenda, if it exists? Is this Forum, for example, a useful exercise?*

A number of participants said that the “Southern Agenda” on investment is undergoing a transformation, as capital increasingly flows South-South. This has brought a growing number of investment treaties between developing countries, where traditionally they have been between developed and developing states. While the bulk of investment arbitrations have been targeted against developing countries, or those with economies in transition, this situation is also changing. NAFTA has seen Canada and the United States on the receiving end of a large number of treaty-based investment claims. In response, both governments have emphasized the right to regulate in the public interest in their more recent IIAs.

However, it was also said that while developing countries have different interests, they also have shared interests. There are challenges related to negotiating IIAs which are particularly problematic for developing countries. At the top of the list is the need to strengthen capacity to negotiate informed and strategic treaties. It was stressed that the community of experts on international investment law is relatively small, and that expertise is most lacking in developing countries. It was agreed, therefore, that the capacity building component of the Forum was important, and should complement other work in this area, such as an effort to build a permanent advisory centre on international investment law for developing countries. Participants indicated that the expert views shared in the presentations and supplementary papers were pitched at the right level, and provided useful information.

While the Forum focused primarily on the legal aspects of IIAs, participants said there was also a need to spend more time on the economic angle. It was said that many countries have difficulty evaluating their own economic interests, and that research and capacity building in this area was imperative. Some participants also said it would be important to include political actors in future forums. Having informed negotiators is only half the equation. It is also vital to educate the political spheres who often push for the conclusion of IIAs.

The networking opportunity provided by the Forum was seen as essential, given the lack of other opportunities that exist for developing country negotiators. It was said

that the benefits of this networking opportunity would extend beyond regular forums, by encouraging informal communication between negotiators. It was suggested that ongoing communication between negotiators could be facilitated through list-serves and other on-line forums. But participants also stressed that networking had its limits. While participants said they valued the lessons shared by other countries, it was also emphasized that each government has to take responsibility for its own interests, which will be unique to that country.